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7 July 2022

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To

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~~ENFORCEABILITY UNDER AUSTRALIAN LAW OF THE LIQUIDATION, SET-OFF, NETTING AND CREDIT SUPPORT PROVISIONS OF CERTAIN FUTURES ACCOUNT AGREEMENTS AND A CLEARED DERIVATIVES ADDENDUM UPON A CUSTOMER'S DEFAULT OR INSOLVENCY~~

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PART A. BACKGROUND

Part A 1Introduction

1.1 Instructions

This memorandum considers the validity and enforceability under Australian Law (as defined in paragraph 1.2 below) of the liquidation, set-off, netting and credit support provisions of:

(a) certain Covered Base Agreements (as defined in paragraph A.2.1(a) below), entered into by an entity that is registered with the United States Commodity Futures Trading Commission ("**CFTC**") as a futures commission merchant ("**FCM**") and is a member of one or more CFTC-registered derivatives clearing organisations (each such FCM, a "**Clearing Member**")

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and such Clearing Member's Covered Customer (as defined in paragraph A.2.1(a) below), setting forth the right of such Clearing Member, upon the occurrence of an event giving rise to any right of such Clearing Member to liquidate all Futures Transactions (as defined in paragraph A.2.1(a) below), to liquidate such transactions and to determine amounts owing with respect to those transactions, to exercise remedies in respect of Futures Payment Rights (as defined in paragraph A.2.1(c)(ii) below) and rights of netting and setoff with respect to obligations arising from Futures Transactions and to apply Futures Credit Support (as defined in paragraph A.2.1(c)(i) below) transferred by a Covered Customer in connection with them; and

an addendum for Cleared Derivatives Transactions ((b) a "**CDA**"), entered into by a Clearing Member and such Clearing Member's Covered Customer, setting forth the right of such Clearing Member, upon the occurrence of an event giving rise to any right of such Clearing Member to liquidate either (i) all Cleared Derivatives Transactions (as defined below) or (ii) any Cleared Derivatives Transactions affected by a Tax Liquidation Event (as defined in the form of Cleared Derivatives Addendum published by the FIA and ISDA), under a Covered Base Agreement, to liquidate such transactions and to determine amounts owing with respect to those transactions, to exercise remedies in respect of Cleared Derivatives Payment Rights (as defined in paragraph A.2.2(c)(ii) below) and rights of netting and set-off with respect to obligations arising from Cleared Derivatives Transactions, to apply Cleared Derivatives Credit Support (as defined in paragraph 2.2(c)(i) below) transferred by a Covered Customer in connection with them and to offset obligations arising from Cleared Derivatives Transactions against Cleared Derivatives Credit Support transferred to the Covered Customer.

As requested, we have addressed the issues raised by ISDA in its letter to us of October 1, 2013 ("**Instruction Letter**") on the basis of the assumptions that we have been asked to make. We have also set out in this memorandum certain other assumptions that we consider necessary in order for us to answer the questions posed.

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1.2 Scope

This memorandum is given on the laws of the Commonwealth of Australia, New South Wales, Victoria, Queensland, Western Australia and the Australian Capital Territory (each an "**Australian Jurisdiction**"). The opinions expressed in this memorandum are limited to these laws. We express no opinion about the laws of any jurisdiction other than the Australian Jurisdictions, or commercial, accounting, financial, prudential or factual matters. However, the *Corporations Act 2001* (Cth) ("***Corporations Act***") is uniform throughout Australia and the other statutes mentioned in this memorandum are Commonwealth statutes (other than the statutes relating to stamp duty). In this memorandum, the courts of the Australian Jurisdictions are sometimes referred to as the "**Australian Courts**" and the laws in force in the Australian Jurisdictions are sometimes referred to as "**Australian Law**".

This memorandum is subject to the following:

1 Overview

We have acted as Australian legal advisers to the Futures Industry Association ("**FIA**") and the International Swaps and Derivatives Association, Inc. ("**ISDA**") in connection with this opinion.

In this opinion, we address the enforceability under Australian Law of the Position Liquidation, Margin Liquidation and Determination of Account provisions of the Clearing Agreement pursuant to which an FCM registered with the CFTC clears U.S. Futures, Foreign Futures and Cleared Swaps for a Covered Customer, and the creation, perfection and enforcement of the FCM's Security Interest in Covered Collateral.

The analysis that follows is split into the following parts.

- Part A sets out the scope of this opinion and the assumptions to which it is subject;
- Part B and Part C provide context with respect to the U.S. Clearing Model, and the 'trust theory' and 'close-out netting theory' in respect of it, (respectively) by reference to the S&C Memorandum and the summary of the U.S. Clearing Model provided by the FIA and ISDA set out in Annex 1 of this opinion (the "**Summary Annex**");

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- Part D considers the 'trust theory' and Part E considers the 'close-out netting theory';
- Part F sets out our responses to questions on Position Liquidation, Margin Liquidation and Determination of Account by reference to the analysis in Part D and Part E;
- Part G considers the validity, perfection and enforcement of the Security Interest granted by the Covered Customer to the FCM in Covered Collateral; and
- Part H sets out the qualifications to which this opinion is subject.

2 Australian Law

This opinion is limited to, and shall only be construed in accordance with, Australian Law, as applied by the Australian Courts and in effect on the date of this opinion. Accordingly, this opinion does not address the laws of any jurisdiction other than the Australian Jurisdictions. However, both the Corporations Act and the Netting Act are Commonwealth Acts applicable to all the States and Territories of Australia. As our conclusions are based on this legislation, we are aware of no reason why the conclusions in this opinion would not be applicable in the other Australian States and Territories.

(a)The advice in this memorandum is only in relation to Australian Law as it stands at the date of this memorandum, and we have assumed that no law of a This opinion does not take into account any impact that the laws (including any insolvency or bankruptcy laws) of any jurisdiction other than the Australian Jurisdictions adversely affects the conclusions in this memorandum.may have on the statements made in this opinion even if, as a result of the application of Australian Law provisions on the conflict of laws, the laws of any such other jurisdiction may apply.

(b)This memorandum incorporates all the assumptions contained in the Instruction Letter This opinion incorporates all the assumptions contained in the Instructions (which for convenience are repeated in Schedule 1 to this memorandum).is set out in Annex 2 of this opinion).

We do not undertake to update this opinion, including in the event of a change in law or practice.

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3 Interpretation

3.1 Definitions

In this opinion:

(a) "**Account Class**" has the meaning given to it in the Summary Annex;

(b) "**APRA**" means the Australian Prudential Regulation Authority;

(c) "**Australian Bank**" or "**ADI**" means an Australian Company which is also an authorised deposit-taking institution (as defined in the Banking Act);

(d) "**Australian Company**" has the meaning given to it in paragraph 4 of this Part A;

(e) "**Australian Court**" means a court of ~~has its centre of main interests in Australia (for the purposes of the~~ the Australian Jurisdictions including the High Court of Australia and the Federal Court of Australia;

(f) "**Australian Jurisdictions**" means the Commonwealth of Australia, the States of New South Wales, Victoria, Queensland and Western Australia and the Australian Capital Territory. However, see paragraph 2 of this Part A as to the applicability to other jurisdictions within Australia;

(g) "**Australian Law**" means the law of the Australian Jurisdictions;

(h) "**Banking Act**" means the *Banking Act 1959* (Cth);

(i) "**Business Transfer Act**" means the *Financial Sector (Transfer and Restructure) Act 1999* (Cth);

(j) "**CDA**" means an addendum for Cleared Derivatives Transactions in the forms published by FIA and ISDA in 2012 or 2018;

(k) "**Cleared Derivatives Transactions**" has the meaning given to it in the CDA;

(l) "**Cleared Swaps**" has the meaning given to it in the Summary Annex;

(m) "**Clearing Agreement**" or "**Covered Agreement**" means the documentation entered into between a Customer and the FCM being any of:

(i) a customer account agreement governed by the law of the State of New York (a "**Base Account Agreement**"), if the Customer is trading only Futures;

(ii) a Base Account Agreement with a CDA governed by the law of the State of New York, if the Customer is trading only Cleared Swaps or both Futures and Cleared Swaps; and

(iii) one or more other documents relating to the terms of the relationship between the FCM and the Customer, each governed by the law of the State of New York,

in each case including any DCO rules (or clearing agreement between the FCM and its Foreign Futures Broker) to which it is subject;

(n) "**Collateral Protection Act**" means the *Financial System Legislation Amendment (Resilience and Collateral Protection) Act 2016* (Cth);

(o) "**Convention**" has the meaning given to it in paragraph 4.1(a)(i) of Part B;

(p) "**Corporations Act**" means the *Corporations Act 2001* (Cth);

(q) "**Covered Collateral**" or "**Customer Collateral**" means:

(i) the Customer Account;

(ii) the Customer Transactions;

(iii) cash credited to an account (as opposed to physical notes and coins); and

(iv) the types of securities that are identified in additional assumption in II.B.(c) of the Instructions in Annex 2 to this opinion.

Please see Part G for further consideration of the Covered Collateral or Customer Collateral;

(r) "**Covered Contract**" means the types of transactions that may be cleared for the Customer pursuant to the Clearing Agreement, including U.S. Futures, Foreign Futures and Cleared Swaps;

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(s) "**Covered Customer**" or "**Customer**" means a customer of the FCM which has entered into a Clearing Agreement with the FCM and is an entity type that is within the scope of this opinion, as set out in paragraph 4 of this Part A;

(t) "**Cross-Border Insolvency Act**" means the *Cross-Border Insolvency Act 2008* (Cth);

(u) "**Customer Account**" has the meaning given to it in the Summary Annex;

(v) "**Customer Funds**" has the meaning given to it in the Summary Annex;

(w) "**Customer Property Rules**" has the meaning given to it in the Summary Annex;

(x) "**Customer Transaction**" means a futures transaction, options on futures transaction, and/or Cleared Derivatives Transaction cleared by a DCO (or by the Foreign Futures Broker through the relevant foreign clearing organisation) pursuant to a Clearing Agreement;

(y) "**DCO**" means one or more derivatives clearing organisations registered with the U.S. Commodity Futures Trading Commission (the "**CFTC**") pursuant to the U.S. Commodity Exchange Act (the "**CEA**"), each of which acts as a central counterparty for exchange-traded futures and options on futures transactions and/or swaps transactions (as defined in the CEA and the CFTC regulations thereunder), which may initially be effected on an exchange, by means of another execution facility or over the counter;

(z) "**Determination of Account**" has the meaning given to it in the Summary Annex;

(aa) "**Event of Default**" means an event of default (whether or not described as an "event of default") contained within a Base Account Agreement or a CDA;

(bb) "**Excluded Company**" means a company that is:

(i) established under statute (other than the Corporations Act);

(ii) a private health insurer;

(iii) a friendly society; or

(iv) a corporate collective investment vehicle;

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(cc) "**FCM**" means a futures commission merchant registered with the CFTC;

(dd) "**Foreign Futures**" has the meaning given to it in the Summary Annex;

(ee) "**Foreign Futures Broker**" has the meaning given to it in the Summary Annex;

(ff) "**Futures**" has the meaning given to it in the Summary Annex;

(gg) "**General Insolvency Principles**" has the meaning given to it in paragraph 3 of Part B;

(hh) "**General Insurer**" means an Australian Company that is authorised under section 12 of the Insurance Act to carry on an insurance business in Australia;

(ii) "**Industry Acts**" means the Banking Act, Business Transfer Act, Insurance Act and the Life Insurance Act;

(jj) "**Instructions**" has the meaning given to it in paragraph 1 of this Part A and is set out in Annex 2;

(kk) "**Insurance Act**" means the *Insurance Act 1973* (Cth);

(ll) "**Insurer**" includes (i) a General Insurer and (ii) a Life Company;

(mm) "**Life Company**" means an Australian Company that is a "life company" as defined under the Life Insurance Act;

(nn) "**Life Insurance Act**" means the *Life Insurance Act 1995* (Cth);

(oo) "**Liquidation**" means either or both of a Position Liquidation or Margin Liquidation;

(pp) "**Margin Liquidation**" has the meaning given to it in the Summary Annex;

(qq) "**Model Law**" means ~~(c) We assume in this memorandum that the Covered Customer is an "**Australian Company**" which means a company which is registered as a company under the~~

Corporations Act (which UNCITRAL Model Law on Cross-Border Insolvency ("**Model Law**")).[1] as adopted in Australia in the Cross-Border Insolvency Act;

(rr) "**Net Liquidating Equity**" has the meaning given to the term "net liquidating equity" in the Summary Annex;

(ss) "**Netting Act**" means the *Payment Systems and Netting Act 1998* (Cth);

(tt) "**Netting Regulations**" means the *Payment Systems and Netting Regulations 2001* (Cth);

(uu) "**NOHC**" means an authorised non-operating holding company of an Australian Bank or General Insurer or a registered non-operating holding company of a Life Company (as defined in the Life Insurance Act), as the context requires;

(vv) "**Offsetting Transaction**" has the meaning given to the term "offsetting transaction" in the Summary Annex;

(ww) "**PPSA**" means the *Personal Property Securities Act 2009* (Cth);

(xx) "**Permitted Uses**" has the meaning given to it in the Summary Annex;

(yy) "**Position Liquidation**" has the meaning given to it in the Summary Annex;

(zz) "**RBA**" means the Reserve Bank of Australia;

(aaa) "**Regulated Body**" means a body corporate that is an Australian Bank or Insurer, a NOHC, or a Subsidiary, as the context requires;

(bbb) "**Relevant Relationship**" has the meaning given in paragraph 2 of Part B;

(ccc) "**Reserve Bank Act**" means the *Reserve Bank Act 1959* (Cth);

[1] Although foreign companies may need to be registered under the *Corporations Act 2001* (Cth), due to the structure of that legislation, such companies are not included in the reference to companies registered under the *Corporations Act* and are not "Australian companies" for the purposes of this memorandum.

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(ddd) "**Residual Interest**" has the meaning given to the term "residual interest" in the Summary Annex;

(eee) "**Security Interest**" means the security interest granted by the Customer to the FCM in the Covered Collateral;

(fff) "**Segregated Funds**" has the meaning given to it in the Summary Annex;

(ggg) "**Segregated Funds Account**" has the meaning given to it in the Summary Annex;

(hhh) "**Segregation Rules**" means the Customer Property Rules applicable to U.S. Futures and/or Cleared Swaps, as the context requires;

(iii) "**Separate Account**" has the meaning given to it in the Summary Annex;

(jjj) "**Separate Account Funds**" has the meaning given to it in the Summary Annex;

(kkk) "**SIS Act**" means the *Superannuation Industry (Supervision) Act 1993* (Cth);

(lll) "**Specified Stay Provisions**" has the meaning given to that term in the Netting Act, as described in Schedule 4 and paragraph 3 of Part E;

(mmm) "**Statutory Avoidance Provisions**" has the meaning given to it in paragraph 4 of Part B;

(nnn) "**Statutory Trusts**" means the separate statutory trusts established over all the Customer Funds held by the FCM for the benefit of its customers in each applicable Account Class as described in the S&C Memorandum and Summary Annex ("**Statutory Trust**" may refer, as the context requires, to any Statutory Trust or all Statutory Trusts on a combined basis);

(ooo) "**Statutory Trust Beneficial Interest**" means a Customer's beneficial interest in the Statutory Trust Property;

(ppp) "**Statutory Trust Property**" means the Segregated Funds and/or Separate Account Funds (as applicable) held by the FCM on the terms of the applicable Statutory Trust(s);

(qqq) "**Subsidiary**" means a subsidiary (as that is determined under the Corporations Act) of an Authorised Deposit-taking Institution (as defined in the Banking Act), an Insurer or a NOHC;

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(rrr) "**Summary Annex**" has the meaning given to it in paragraph 1 of this Part A;

(sss) "**S&C Memorandum**" has the meaning given to it in paragraph 5 of this Part A;

(ttt) "**Transaction**" means any transaction entered into pursuant to a Clearing Agreement, including Customer Transactions, Offsetting Transactions, risk-reducing transactions, hedging transactions and any transaction entered into in order to effect a Position Liquidation (if any), including causing book-entry transfers of Customer Transactions out of the Customer Account;[1]

(uuu) "**U.S. Clearing Model**" has the meaning given to it in paragraph 5 of this Part A; and

(vvv) "**U.S. Futures**" has the meaning given to it in the Summary Annex.

3.2 Insolvency Proceedings

In this opinion, references to insolvency proceedings refer to the following proceedings governed by Australian law to which an Australian Company may be subject:

(a) winding up;

(b) compromise or arrangement with creditors;

(c) administration;

(d) appointment of a receiver;

(e) appointment of a statutory manager to an Australian Bank or to an Insurer;

(f) appointment of a statutory manager to an Australian incorporated NOHC or to a Subsidiary which satisfies certain conditions;

(g) appointment of a judicial manager to a Life Company (or part of the business of a Life Company) or to a General Insurer; and

[1] Further details in respect of the operation of the liquidation mechanics under the Clearing Agreement are set out in the Summary Annex.

(h) appointment of an acting trustee of a superannuation entity under the SIS Act where the acting trustee is appointed because the superannuation entity is insolvent, or is likely to become, insolvent.[2]

We do not consider in this opinion the insolvency of any entity other than a Customer which is an Australian Company. For example, we do not consider any Customer which is an Excluded Company. Further, we assume that no other party (including the FCM (other than for the purposes of our response to question 12 in Part G below), any DCO or Foreign Futures Broker) is subject to any insolvency proceeding.

4 Scope covered by this opinion

The term Australian Company includes all Australian authorised deposit-taking institutions ("**ADIs**") incorporated under Australian law, and most life companies, [2]trustees of superannuation entities[3] and trustees of unit trusts (including managed investment schemes),[4] general insurers,[5] and other Australian business entities likely to be trading in derivatives are companies which have been or are taken to have been registered as a company under the *Corporations Act*. However, this needs to be confirmed in each case.

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[2] An enquiry needs to be made of APRA to find out whether an acting trustee has been appointed because the trustee of the superannuation entity is insolvent or likely to become insolvent. However it would be reasonable to expect that there would be publicity attached to such an appointment.

[2] For the purposes of this memorandum, a "life company" means an Australian Company that is a "life company" as defined in the *Life Insurance Act 1995* (Cth) ("***Life Insurance Act***").

[3] For the purposes of this memorandum, "superannuation entity" means a regulated superannuation fund (other than a self-managed superannuation fund), an approved deposit fund, or a pooled superannuation trust (each as those terms are defined in the *Superannuation Industry (Supervision) Act 1993* (Cth) ("***SIS Act***")). We do not opine in this memorandum on any other type of superannuation trust.

[4] Under Australian Law, superannuation funds, managed investment schemes and other trusts are not legal entities. The relevant entity is the superannuation trustee acting in its capacity as trustee of the superannuation fund, the responsible entity of the scheme or the trustee of the other trust, respectively.

[5] For the purposes of this memorandum, a "general insurer" means a body corporate which is an Australian company that is authorised under section 12 of the *Insurance Act 1973* (Cth) ("***Insurance Act***") to carry on an insurance business in Australia.

The term Australian Company does not include foreign companies or entities, companies which do not have their centre of main interests in Australia for the purposes of the Model Law, private health insurers, the Crown and statutory corporations organised under any Australian law.

We set out in Appendix B (September 2009) further information on whether entities meeting particular descriptions would, or could, be Australian Companies.

As noted in paragraph B.2.12, additional analysis may be required when considering insolvency set-off against an Australian Company that is acting in a special capacity (for example, this includes general insurers, life insurers and trustees, including superannuation trustees and responsible entities of managed investment schemes). As noted in paragraph C.V.20, additional analysis may also be required in respect of the grant of security interests by insurers and superannuation entities.

(d) You have asked that we consider the list of Covered Transactions in Appendix A (August 2015).

(e)You have asked us, when responding to each question, to distinguish between the following three fact patterns:

(a) (i)The Location of the Covered Customer is in Australia and the Location of the Eligible Covered Collateral is outside Australia.

(b) (ii)The Location of the Covered Customer is in Australia and the Location of the Eligible Covered Collateral is in Australia.

(c) (iii)The Location of the Covered Customer is outside Australia and the Location of the Eligible Covered Collateral is in Australia.

For these purposes "Location" is determined by reference to the rules in the *Personal Property Securities Act 2009* (Cth) (" PPSA") which are described in paragraph C.I.2.5 of this memorandum.We consider the enforceability under Australian Law of each of the Covered Base Agreement and CDA, against a Covered Customer that is an Australian Company. Where the lSchedule 2. Where the Location of the Eligible Covered Collateral or the jurisdiction in which a

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~~company~~ Customer is organised or its status affects our analysis, it is generally clear from the wording of our ~~memorandum~~opinion.

~~We do not consider in this memorandum~~ In this opinion we consider the issues that you have asked us to address only in respect of an "**Australian Company**" which is registered as a company under the Corporations Act and including, without limitation:

(i) a Bank/Credit Institution, if it is an Australian Bank;

(ii) an Investment Firm/Broker Dealer, if it is established as an Australian Company, including a trustee of a unit trust (including where it is a managed investment scheme);[3] and

(iii) a Pension Fund, if it is established as an Australian Company and is a trustee of a superannuation entity.[4,5]

However, the term Australian Company does not include foreign companies or entities, Excluded Companies or the Crown.

We assume in this opinion that each Australian Company (other than an Australian Bank or Insurer[6]) has its centre of main interests for the purposes of the Model Law in Australia[7] and the term Australian

[3] Under Australian Law, managed investment schemes and trusts are not legal entities. The relevant legal entity is the responsible entity acting in its capacity as responsible entity of the managed investment scheme or the trustee of the trust (as applicable).

[4] For the purposes of this opinion, "superannuation entity" means a regulated superannuation fund (other than a self-managed superannuation fund), an approved deposit fund, or a pooled superannuation trust (each as those terms are defined in the SIS Act). We do not opine in this opinion on any other type of superannuation trust. Under Australian Law, superannuation entities are not legal entities. The relevant legal entity which should be the counterparty to the Clearing Agreement is the superannuation trustee acting in its capacity as trustee of the superannuation entity and this is the legal entity with which the FCM should contract.

[5] In this opinion, we do not consider a company that could become subject to small business restructuring under Part 5.3B of the Corporations Act, on the basis that, in order to be eligible for such restructuring, the total liabilities of the company on the day the restructuring begins must not exceed A$1 million.

[6] The Model Law does not apply to an Australian Bank or an Insurer: Article 1, paragraph 2 of the Model Law, section 9 of the Cross-Border Insolvency Act and regulation 4 of the *Cross-Border Insolvency Regulations 2008* (Cth)

[7] In the absence of evidence to the contrary, a company's centre of main interests will be presumed to be its registered office: see Article 16(3) of the Model Law.

Company, other than as it applies to Australian Banks and Insurers, does not cover companies which do not have their centre of main interests in Australia for the purposes of the Model Law.

More generally, we do not advise in this opinion on regulatory issues relating to dealings with any counterparty type falling within the scope of this opinion nor do we consider the effect of a breach of or non-compliance with applicable regulation on the conclusions in this opinion.

We set out in Appendix A (September 2009) further information on whether entities meeting particular descriptions would, or could, be Australian Companies.

As noted in paragraph D.4.1 below, additional analysis may also be required in respect of the grant of security interests by trustees of superannuation entities and Life Companies.

(f)We do not consider any other type of entity or the insolvency of any entity other than an Australian Company.

(g) This memorandum is given for the sole benefit of ISDA and FIA, and each of their members, and may not be relied upon by any other person unless we otherwise specifically agree with that person in writing.

2 Covered Base Agreements and CDAs

In accordance with the Instruction Letter, we assume the following:

2.1 Covered Base Agreements

(a) Pursuant to a futures customer account agreement (a "**Covered Base Agreement**") entered into between a Clearing Member and an Australian Company (as defined above) (a "**Covered Customer**"), the Clearing Member agrees to carry one or more accounts on behalf of that Covered Customer (each, an "**Account**") and to execute, carry and clear transactions for the purchase or sale of commodities for future delivery on, or subject to the rules of, a derivatives clearing organization (a "**DCO**") registered as such under the United States Commodity Exchange Act (the "**CEA**") or traded on, or subject to the rules of, a board of trade outside the United States (such contracts executed on a contract market designated pursuant to Section 5 of the CEA and cleared by a U.S.-registered DCO, "**U.S.**

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Futures", such contracts traded on or subject to the rules of, a board of trade outside the United States, and options thereon, "**Foreign Futures**" and, collectively "**Futures**") and/or options on United States Futures subject to Part 33 of the rules of the CFTC (such contracts, "**Options**", and collectively with Futures, "**Futures Transactions**"). With respect to Foreign Futures, the Clearing Member acts for the Covered Customer by carrying Foreign Futures on the Covered Customer's behalf with, and guaranteeing the Covered Customer's performance to, clearing members ("**Foreign Clearing Members**") of the relevant foreign clearinghouses, which Foreign Clearing Members may frequently be affiliates of the Clearing Member, and the Foreign Clearing Members will, in turn, enter into back-to-back futures transactions cleared by foreign clearinghouses.

(b) Each Covered Base Agreement is governed by New York law.

(c) Pursuant to a Covered Base Agreement, the Covered Customer agrees to transfer, as applicable, initial margin and variation margin payments as the Clearing Member may require in respect of the Covered Customer's Futures Transactions. Also, pursuant to the Covered Base Agreement, the Covered Customer grants a security interest to the Clearing Member in all of the Covered Customer's rights in the following property, whether at the time of the grant or thereafter existing:

(i) "**Futures Credit Support**", meaning:

(A) with respect to U.S. Futures and Options, its Account and all assets credited thereto, including assets held by a DCO, as well as other property of the Covered Customer held in respect of Futures Transactions by or for the Clearing Member, the DCO or any agent acting for the Clearing Member, the DCO or the Covered Customer;

(B) with respect to Foreign Futures, its Account and all assets credited thereto, including assets held by a foreign Clearing Member or foreign clearinghouse, as well as other property of the Covered Customer held in respect of Futures Transactions by or for, or for the Account and due from, the Clearing Member, any foreign Clearing Member, any foreign

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clearinghouse or others, or any agent acting for the Clearing Member, any foreign Clearing Member, any foreign clearinghouse or others; and

(ii) "**Futures Payment Rights**", meaning:

(A) with respect to U.S. Futures and Options, its Futures Transactions and all rights to payment thereunder (whether constituting obligations of the Clearing Member or a DCO);

(B) with respect to Foreign Futures, its Futures Transactions and all rights to payment thereunder (whether constituting obligations of the Clearing Member, a foreign Clearing Member or a foreign clearinghouse).

(d) The security interest secures all obligations of the Covered Customer to the Clearing Member under the Covered Base Agreement.

(e) A Covered Base Agreement contains one or more events of default (whether or not described in it as "events of default") (each, an "**Event of Default**"), the effect of which is to give the Clearing Member the right to liquidate the Futures Transactions held in the Covered Customer's Account ("**Futures Liquidation Rights**"). Among such Events of Default are defaults predicated on:

(i) a Covered Customer's filing under applicable bankruptcy or similar insolvency laws;

(ii) the filing of a petition for the commencement of involuntary proceedings in respect of the Covered Customer under applicable bankruptcy or similar insolvency laws which filing results in a judgment of insolvency or bankruptcy or an order for relief; and

(iii) the appointment in respect of the Covered Customer or substantially all of its assets of an administrator, conservator, receiver or similar official, including the possession and control of the property of the Covered Customer by such an official pursuant to seizure orders.

The terms of the Covered Base Agreement provide the Clearing Member with the right under all applicable laws as a secured party to exercise remedies in respect of Futures Payment Rights

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and to net and set off amounts owing under Futures Transactions on account of their liquidation and termination (collectively, "**Futures Netting Rights**"). To the extent we refer in this memorandum to Futures Netting Rights in the context of close-out netting and the protection afforded by the *Payment Systems and Netting Act 1998* (Cth) ("***Netting Act***") to close-out netting, we refer only to the contractual rights which provide for the calculation and netting of termination values of the obligations under the Covered Base Agreement which have been terminated which comprise the Futures Netting Rights and do not comment on any other rights (such as rights as a secured party) which may comprise the Futures Netting Rights. To the extent we refer in this memorandum to the Futures Netting Rights in the context of exercising rights as a secured party and the protection afforded by the *Netting Act* to enforcement of security, we refer only to those rights which the Clearing Member has to exercise remedies as a secured party under the Covered Base Agreement.

(f) The Covered Base Agreement includes a provision, the effect of which is to permit the Clearing Member, upon the occurrence of an Event of Default in respect of a Covered Customer, to dispose of or realize all Futures Credit Support posted by the Covered Customer to the Clearing Member in respect of Futures Transactions and net or apply the foregoing or the liquidation value thereof to any obligations the Covered Customer owes to the Clearing Member under the Covered Base Agreement (collectively, "**Futures Credit Support Rights**").

(g) A futures account agreement that does not alone satisfy the above requirements is nevertheless a "Covered Base Agreement" to the extent it is paired with a CDA that supplies any of the otherwise unsatisfied requirements.

2.2 The CDA

(a) In addition to entering into a Covered Base Agreement with the Covered Customer, the Clearing Member and the Covered Customer execute the CDA. The CDA supplements a Covered Base Agreement with respect to, among other things, the liquidation and netting of "Cleared Derivatives Transactions" carried in the Covered Customer's account holding Cleared Derivatives Transactions (the "**Cleared Derivatives Account**"), as well as the application of collateral related to those Cleared Derivatives Transactions. "**Cleared**

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Derivatives Transactions" are swaps, forwards, options, or similar transactions (but excluding Futures Transactions executed on or subject to the rules of a U.S. designated contract market or on a foreign board of trade and subject to regulation in that jurisdiction) that are (a) entered into by a Covered Customer in the over-the-counter market, or (b) executed or traded by such Covered Customer on or subject to the rules or protocols of any multilateral or other trading facility, system or platform, including any communication network or auction facility permitted under applicable law or any designated contract market and, in either case, subsequently submitted to and accepted for clearing by a DCO and subject to the CFTC's Part 22 rules. To the extent that a security-based swap is, in accordance with applicable law, carried by an FCM in a cleared swaps customer account (as defined in the CFTC's Part 22 rules), such security-based swap constitutes a Cleared Derivatives Transaction. A list of example types of Cleared Derivatives Transactions appears in Appendix A. In this memorandum, Cleared Derivatives Transactions and Futures Transactions are together referred to as "**Covered Transactions**".

(b) Each CDA is governed by New York law.

(c) Pursuant to the CDA, Cleared Derivatives Transactions become incorporated into the related Covered Base Agreement, which incorporation is accomplished by considering references to "Contracts," "Futures," "Futures Contracts" and similar terms in such Covered Base Agreement to include references to the Cleared Derivatives Transactions. Through this incorporation, the Covered Customer grants a security interest to the Clearing Member in all of the Covered Customer's rights in the following property, whether at the time of the grant or thereafter existing:

(i) (1) its Cleared Derivatives Account and all assets credited thereto, including assets held by a DCO, and (2) other property of the Covered Customer held in respect of Cleared Derivatives Transactions by or for the Clearing Member, the DCO and any agent acting for the Clearing Member, the DCO or the Covered Customer (collectively, "**Cleared Derivatives Credit Support**"); and

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(ii) its Cleared Derivatives Transactions and all rights to payment thereunder (whether constituting obligations of the Clearing Member or a DCO) (collectively, "**Cleared Derivatives Payment Rights**").

(d) Pursuant to the CDA, following the occurrence of an Event of Default, the Clearing Member is entitled to set off or apply any margin transferred to the Covered Customer under Cleared Derivatives Transactions ("**Customer Received Margin**") against obligations to the Covered Customer under the CDA.

(e) The Clearing Member is entitled, upon the occurrence of an Event of Default, to designate a date on which it can cause the liquidation of a Covered Customer's Cleared Derivatives Transactions (such rights, the "**Cleared Derivatives Liquidation Rights**"). The Clearing Member is entitled under all applicable laws to exercise its remedies as a secured party in respect of Cleared Derivatives Payment Rights and to net amounts owing in respect of liquidated Cleared Derivatives Transactions (collectively, "**Cleared Derivatives Netting Rights**"). To the extent we refer in this memorandum to Cleared Derivatives Netting Rights in the context of close-out netting and the protection afforded by the *Netting Act* to close-out netting, we refer only to those rights to the extent they encompass contractual rights which provide for the calculation and netting of termination values of the obligations under the CDA which have been terminated and do not comment on any other rights (such as rights as a secured party) which may comprise the Cleared Derivatives Netting Rights. To the extent we refer in this memorandum to the Cleared Derivatives Netting Rights in the context of exercising rights as a secured party and the protection afforded by the *Netting Act* to enforcement of security, we refer only to those rights which the Clearing Member has to exercise remedies as a secured party under the CDA.

(f) Upon the liquidation of a Covered Customer's Cleared Derivatives Transactions, the CDA provides the Clearing Member with rights to (a) dispose of or realize on Cleared Derivatives Credit Support posted by the Covered Customer to the Clearing Member in respect of Cleared Derivatives Transactions and net or apply the foregoing or the liquidation value thereof to any obligations the Covered Customer owes to the Clearing Member under the CDA and (b) net or apply the value of any Customer Received Margin against any

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obligations owed to the Covered Customer under the CDA (such rights, the "**Cleared Derivatives Credit Support Rights**").

(g) The "FIA-ISDA Cleared Derivatives Addendum" in the form published jointly by the FIA and ISDA satisfies the above requirements.

(h) A CDA that does not alone satisfy the above requirements is nevertheless a "CDA" to the extent it is paired with a Covered Base Agreement that supplies any of the otherwise unsatisfied requirements. In addition, a single document that satisfies the above requirements for a Covered Base Agreement and a CDA is both a "Covered Base Agreement" and a "CDA."

2.3 Covered Base Agreement and CDA

We assume that the Covered Base Agreement and Futures Transactions together, and the CDA and Cleared Derivative Transactions together, each form a single bilateral agreement between the Covered Customer and the Clearing Member under all applicable laws.

2.4 Assumptions

Additional assumptions that we have been asked to make, together with certain other assumptions that we consider necessary in order for us to answer the questions posed, are set out in Schedule 1.

PART B: NETTING UNDER A COVERED BASE AGREEMENT AND CDA

2.5 Insolvency Proceedings

The reorganisation, liquidation or other insolvency proceedings to which an Australian Company may become subject are the following:

(a) winding up;

(b) compromise or arrangement with creditors;

(c) administration;

(d) receivership;

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(e) appointment of a statutory manager to an ADI;[6]

(f) appointment of a judicial manager to a life company;[7]

(g) appointment of a judicial manager to a general insurer; [8]or

(h) appointment of an acting trustee of a superannuation entity under the *SIS Act* where the acting trustee is appointed because the superannuation entity is insolvent, or is likely to become, insolvent,

5 Scope of material reviewed

For the purposes of this opinion, we have read the memorandum prepared by Sullivan & Cromwell LLP entitled "Memorandum to the Futures Industry Association and the International Swaps and Derivatives Association, Inc. Regarding Futures and Options Transactions, Cleared Swaps and Foreign Futures Transactions Executed and Carried by Futures Commission Merchants for Their Customers" dated November 17, 2021 (the "**S&C Memorandum**") and the supplementary summary of the U.S. clearing model set out in the Summary Annex (the "**U.S. Clearing Model**") and assume the following:

(a) the characterisation and legal effect of the relationships between an FCM, a Customer and a DCO (or Foreign Futures Broker) (including the rights and obligations of such parties under the Clearing Agreement) under U.S. Federal law and the law of the State of New York, as applicable, are as set out in the S&C Memorandum;

[6] Appointment of a statutory manager means the taking control of an ADI's business by a statutory manager under the *Banking Act 1959* (Cth) ("***Banking Act***").

[7] Appointment of a judicial manager in this context refers to where the Australian Company that is a life company, or a part of the Australian Company's business, comes under judicial management under the *Life Insurance Act*.

[8] Appointment of a judicial manager in this context means the vesting of the management of a general insurer in a judicial manager under the *Insurance Act*.

(b) the liquidation process (including the methods by which an FCM may effect a liquidation) following a Customer default under the terms of the Clearing Agreement and its legal effect under the law of the State of New York are as set out in the S&C Memorandum; and

(c) the security interest granted by the Customer to the FCM is in the form and over the types of assets set out in the S&C Memorandum.

We have not repeated the provisions of the S&C Memorandum or Summary Annex in this opinion and this opinion should be read in conjunction with the S&C Memorandum and the Summary Annex.

For the avoidance of doubt, for the purposes of this opinion, we have only relied on explanations of the terms of certain underlying documents, as well as the summary of the U.S. Clearing Model set out in the Summary Annex, the S&C Memorandum and the Instructions and we have not reviewed any other documents. We rely on the contents of the Summary Annex, the S&C Memorandum and the Instructions without any further checks for the purposes of providing this opinion.

Our analysis is strictly limited to the issues specifically addressed in this opinion and does not apply by implication to other matters.

6 Assumptions

Our analysis is subject to the assumptions contained within your Instructions (set out in Annex 2), the scope described in paragraph 5 of this Part A and the following additional assumptions:

(a) the Clearing Agreement, applicable DCO rules (or the clearing agreement between the FCM and its Foreign Futures Broker) and the Transactions entered into thereunder constitute legal, valid, binding and enforceable obligations as regards the relevant DCO (or Foreign Futures Broker), FCM and the Customer who are party to them under New York law (or the law governing the clearing agreement between the FCM and its Foreign Futures Broker);

(b) the applicable DCO rules (or the clearing agreement between the FCM and its Foreign Futures Broker) permit the FCM to effect a Position Liquidation and Margin Liquidation and to enter into Offsetting Transactions, risk-reducing transactions or hedging transactions and/or cause book-entry transfers of Transactions following a Customer default, as set out in the S&C Memorandum;

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(c) each of the FCM and the Customer has obtained all licences, approvals, authorisations and consents under all applicable laws which may be necessary in connection with the Clearing Agreement and any Transaction or arrangement entered into thereunder and is in compliance with all applicable laws in connection with the Clearing Agreement and any Transaction or arrangement entered into thereunder;

(d) neither the FCM nor the Customer is insolvent at the time of entering into the Clearing Agreement or a Transaction under it, or making payments or deliveries between them under the Clearing Agreement or a Transaction under it, nor becomes insolvent as a result of any of them;

(e) the Clearing Agreement and any Transactions or arrangements entered into thereunder (including the transfer of Customer Funds by the Customer to the FCM) were entered into prior to the commencement of any insolvency proceedings in relation to the relevant DCO (or Foreign Futures Broker), FCM or Customer and prior to any such party having notice that any insolvency related events had occurred in relation to the other, except in relation to the Customer at the time of the DCO (or Foreign Futures Broker) and the FCM entering into an Offsetting Transaction, risk-reducing transaction or hedging transaction and/or any transaction entered into in order to effect a Position Liquidation (if any), including causing book-entry transfers of Transactions, where the relevant analysis assumes that such transactions are entered into after the commencement of insolvency proceedings with respect to the Customer;

(f) the Clearing Agreement and all Transactions and arrangements thereunder have been or will be entered into for bona fide commercial reasons, on arm's length commercial terms by the parties so that there is no element of unfair preference of one party against the other party's other creditors and the Clearing Agreement correctly reflects the terms agreed between the parties. In addition, we assume that the Clearing Agreement does not require grossly exorbitant payments and that it does not otherwise grossly contravene ordinary principles of fair dealing;

(g) there are no dealings between the parties that affect the operation or interpretation of any provision of the U.S. Clearing Model, the Clearing Agreement, the applicable DCO rules (or the clearing agreement between the FCM and its Foreign Futures Broker) or rules, any Transaction or arrangement entered into thereunder or any assumptions in this opinion. No agreement or Transaction entered into between the relevant DCO, the FCM (or Foreign Futures Broker),

and/or the Customer, or any other party, amends, varies, waives or otherwise affects in any respect the U.S. Clearing Model, the validity of the Clearing Agreement or the ability of (or requirement for) either party to comply with its obligations under it in such a way that would affect the conclusions reached in this opinion;

(h) the Transactions that are the subject of the Clearing Agreement are not void under gaming and betting legislation and are not in the nature of insurance;[8]

(i) each Customer Transaction, Offsetting Transaction, and/or any transaction entered into in order to effect a Position Liquidation (if any), including causing book-entry transfers of Transactions, will be in accordance with the Clearing Agreement and the applicable DCO rules (or the clearing agreement between the FCM and its Foreign Futures Broker), and none of the provisions of any Transactions will affect the conclusions set out in this opinion;

(j) no security, trust, or other proprietary interest has been granted or exists over or in respect of the Customer Transactions held by the FCM on the terms of the Relevant Relationship or Statutory Trust Property in favour of anyone other than, in the case of the Security Interest, the FCM;

(k) the FCM maintains up-to-date and accurate book-entry records in respect of all Customer Transactions, Customer Accounts, Segregated Funds and Separate Account Funds held by the FCM;

(l) any cash or property held by the FCM (including any cash or property transferred by the Customer to the FCM or received by the FCM from a DCO (or Foreign Futures Broker)) is not subject to the client property and client money rules of the Corporation Act;

(m) Customer Transactions, Segregated Funds and Separate Account Funds do not form part of the FCM's general estate on insolvency. We note that there is some discussion in relation to this

[8] Financial products (including derivatives) are protected from the operation of gaming and betting legislation in the Australian Jurisdictions under section 1101I of the Corporations Act.

assumption in the S&C Memorandum and paragraphs 1.31 to 1.34 of the Summary Annex. Please see footnote 32 of this opinion with respect to this;

(n) New York law and U.S. Federal law provide that the Customer does not have an interest in any specific Customer Transactions held by the FCM on the terms of the Relevant Relationship or asset that constitutes the relevant Statutory Trust Property, but rather has a beneficial interest in such Customer Transactions or relevant Statutory Trust Property (as the case may be) as a whole;[9]

(o) in conducting a Liquidation, the FCM will only withdraw amounts from the Segregated Funds or Separate Account Funds for Permitted Uses;

(p) under U.S. Federal law, a separate Statutory Trust is established over the Customer Funds held by the FCM for the benefit of its customers for each Account Class. As a result, there could be three separate Statutory Trusts arising under the Clearing Agreement;

(q) although the Security Interest may also secure liabilities of the Customer to the FCM other than under the Clearing Agreement,[10] such other liabilities are not considered in this opinion; and

(r) given the governing law of the Covered Agreement, applicable DCO rules and clearing agreement between the FCM and Foreign Futures Broker and foreign clearing organization rules, and the Transactions entered into thereunder is not Australian Law, the rights and obligations of the parties to them entered into thereunder would be determined in the manner described in the Summary Annex, the S&C Memorandum and the Instructions.

* * * * * * *

Part B Australian Law analysis of the contractual provisions and the Relevant Relationship and Statutory Trusts under U.S. Clearing Model

[9] See paragraphs 1.11 and 1.35 of the Summary Annex.

[10] See paragraph 1.37 of the Summary Annex.

0 Introduction

In this Part B we set out our analysis with respect to the recognition under Australian Law of:

(a) New York law as the governing law of the Clearing Agreement and the Relevant Relationship arising under the Clearing Agreement; and

(b) U.S. Federal law as the governing law of the Statutory Trusts arising under the Clearing Agreement.

We note that different conflict of laws principles will apply depending on whether a particular provision of the Clearing Agreement (and, accordingly, the U.S. Clearing Model) is characterised as a contractual provision or a term of a trust.

Accordingly, we advise on the following elements of the U.S. Clearing Model in turn:

(i) the contractual provisions relating to aspects of the Clearing Agreement; and

(ii) the Relevant Relationship described in paragraph 2 below and the Statutory Trusts.

We consider the Determination of Account and Liquidation in Part C to Part F below and the Security Interest in paragraph 2 of Part G below.

1 Relationship between FCM and the Covered Customer

As noted in paragraphs 1.10 and 1.11 of the Summary Annex, although in all cases the FCM enters into the Customer's Covered Contracts as the Customer's agent and upon the instruction and for the risk and benefit of the Customer, the FCM's relationship with the DCO or the FCM's Foreign Futures Broker with respect to the Customer's Covered Contracts is treated by the DCO or Foreign Futures Broker as a principal-to-principal relationship. This principal-to-principal relationship is governed by the terms of the DCO's rules and procedures and membership agreement, or by a contractual arrangement between the FCM and the Foreign Futures Broker (which is likely governed by non-US law), to which the FCM's Customer is in neither case a party. The Customer is not in privity of contract with the DCO or Foreign Futures Broker with respect to the Customer's Covered Contracts, neither the DCO nor the Foreign Futures Broker has any liability to the Customer and the Customer has no rights or claims against the DCO or Foreign Futures Broker. Moreover, from a US law perspective, the FCM

is not in privity of contract with the foreign clearing organization. The FCM is fully liable as principal for all amounts owing to the DCO or foreign clearing broker in connection with the FCM's Covered Contracts. See the S&C Memorandum, Sections VI and VII.

Under these arrangements, the FCM acts as an "agent-trustee" of the Customer with respect to the Customer's Covered Contracts. This reflects the fact that, as the sole counterparty and principal obligor to the DCO or Foreign Futures Broker under the Contracts made on the Customer's behalf with the DCO or Foreign Futures Broker, the FCM holds legal title to (i.e., it is the legal owner of) the Contracts credited to the omnibus customer positions account maintained with the DCO or Foreign Futures Broker. The capacity in which the FCM holds Contracts as agent-trustee for the Customer will be distinct from its capacity as agent-trustee for its other customers.[11]

We refer to this relationship between the FCM and the Covered Customer as the "**Relevant Relationship**".

2 Contractual provisions of the U.S Clearing Model under Australian Law

2.1 Law governing contractual aspects of the Clearing Agreement

In any proceedings properly commenced by a party in an Australian Court claiming enforcement of a Clearing Agreement governed by New York law, the Australian Court will give effect to the choice of New York law as the governing law of the Clearing Agreement but will apply the relevant procedural laws and other laws of the relevant Australian Jurisdictions which apply regardless of the choice of law.

We express no opinion as to whether an Australian Court will give effect to a choice of laws to govern the Clearing Agreement to the extent that the choice of laws applies to non-contractual obligations arising out of, or in connection with, the Clearing Agreement (including, without limitation, non-contractual obligations within the meaning of Regulation No 864/2007 of the European Parliament and

[11] See Section VI of the S&C Memorandum.

of the Council of 11 July 2007 on the law applicable to non-contractual obligations (known as "Rome II")).

If the parties' agreement on the governing law and their submission to jurisdiction were not upheld, the relevant Clearing Agreement would have to be examined by an Australian Court on the basis of Australian Law. These types of proceedings are unusual and it is difficult to be precise about rules an Australian Court will adopt because much depends on the facts and the court has a wide discretion.

We assume that the choice of the laws to govern the Clearing Agreement is in good faith and is not contrary to public policy.

Mandatory provisions of Australian law that apply following commencement of insolvency proceedings are considered in paragraphs 1.2, 3, 4, and 5 of Part D and paragraph 3 of Part E.

3 Trust provisions of the U.S. Clearing Model under Australian Law

3.1 Recognition of trusts under Australian Law

(a) Approach taken

When the Australian Courts are asked to consider the validity of a trust, they must first determine the law chosen to govern its terms.

The Australian Courts determine the governing law:

(i) by applying the *Trusts (Hague Convention) Act 1991* (Cth) (the "**Hague Convention Act**") which (with some omissions and extensions) implements the Hague Convention on the Law Applicable to Trusts and on Their Recognition (the "**Convention**") to those trusts which fall within its scope; and

(ii) for trusts which are outside the scope of the Hague Convention Act, by applying the common law principles governing trust arrangements.

(b) Trusts within the scope of the Hague Convention Act

A trust will be within the scope of the Hague Convention Act if it comes within the following definition of a "trust" set out in the Schedule to the Hague Convention Act:

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> *"[T]he legal relationship created—inter vivos or on death—by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.*
>
> *A trust has the following characteristics—*
>
> *(a) the assets constitute a separate fund and are not a part of the trustee's own estate;*
>
> *(b) title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee;*
>
> *(c) the trustee has the power and the duty, in respect of which [it] is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon [it] by law.*
>
> *The reservation by the settlor of certain rights and powers, and the fact that the trustee may [itself] have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust."*[12]

Article 3 in the Schedule to the Hague Convention Act provides that the Convention applies only to trusts as defined in the Convention if they are "created voluntarily and evidenced in writing".[13] However, Article 3 does not require trusts to have been created in writing. Trusts arising by operation of statute are not included in its scope because they do not arise "voluntarily".[14]

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[12] Article 2 in the Schedule to the Hague Convention Act.

[13] Article 3 in the Schedule to the Hague Convention Act.

[14] This point is made in the Explanatory Notes to the Convention at paragraph 49 (which states that "*in particular, the Convention is not applicable to trusts created by operation of law or by judicial decision*") and *Jacob's Law on Trusts in Australia* (8th Edition), Paragraph 28-04, which also suggests that trusts arising by operation of statute are probably not included. The position where the Statutory Trusts arises by entering into a contract is not considered in this source.

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Nevertheless, as the parties enter into the Clearing Agreement voluntarily, there are good arguments that a result of this voluntary arrangement is that the Statutory Trusts are created. The Statutory Trusts could also, therefore, be understood to be entered into voluntarily.[15]

(c) **Governing law of trusts within the scope of the Hague Convention Act**

If a trust is within the scope of the Hague Convention Act, then the rules of the Hague Convention Act apply to determine its governing law.

The Hague Convention Act codifies a set of rules for identifying the governing law of a trust.[16] The express or implied choice of the settlor takes priority and the settlor's choice is unfettered. If there is no express or implied choice, the governing law is found by applying a series of tests designed to establish the law of the closest connection.

(d) **Governing law of trusts outside the scope of the Hague Convention Act**

In the case of a trust not covered by the Hague Convention Act, the governing law must be established under Australian procedural and evidential rules. This means that it must be pleaded and proved as a fact in accordance with Australian procedural and evidential rules that a law has been chosen to be the governing law of a trust arrangement or (in the case of each Statutory Trust) that the parties have voluntarily entered into arrangements that give rise to a trust governed by particular statutory provisions.

(e) **Scope of the chosen governing law where the Hague Convention Act applies**

Article 8[17] of the Schedule to the Hague Convention Act deals with the governing effects of the chosen law. Of relevance here is that the law chosen governs the validity of the trust, its

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15 This can be contrasted with a trust arising "purely" as a result of statute, such as trusts created in cases of intestacy.

16 Articles 6 and 7 in the Schedule to the Hague Convention Act.

17 "*The law specified by Article 6 or 7 shall govern the validity of the trust, its construction, its effects and the administration of the trust. In particular that law shall govern—*

(a) the appointment, resignation and removal of trustees, the capacity to act as a trustee, and the devolution of the office of trustee;

(b) the rights and duties of trustees among themselves;

construction, its effects and the administration of the trust. It covers relationships between the trustee and the beneficiaries and the extent of all duties owed by the trustee to the beneficiaries, including the duty of care. This is subject to the qualification that the Schedule to the Hague Convention Act does not apply to the validity of acts by which assets are transferred to trustees and does not cover the rights and obligations of third parties to the trust with respect to the trust property.

Article 11 of the Schedule to the Hague Convention Act contains the provisions for recognition. The general scope of the Article is subject to Article 15 (mandatory rules), Article 16 (overriding rules) and Article 18 (public policy) of the Schedule all of which are described and considered more fully in paragraph 4.5 of this Part B.

Article 11 provides that a trust created in accordance with the chosen law is to be recognised as a trust and such recognition implies, as a minimum, that trust property constitutes a separate fund, that the trustee may sue and be sued in its capacity as trustee and that the trustee may appear or act in this capacity before a notary or any person acting in an official capacity.

Article 11 goes on to provide that in so far as the law applicable to the trust requires or provides, amongst other things, such recognition shall imply in particular:

(i) that personal creditors of the trustee shall have no recourse against the trust assets;

(c) the right of trustees to delegate in whole or in part the discharge of their duties or the exercise of their powers;

(d) the power of trustees to administer or to dispose of trust assets, to create security interests in the trust assets, or to acquire new assets;

(e) the powers of investment of trustees;

(f) restrictions upon the duration of the trust, and upon the power to accumulate the income of the trust;

(g) the relationships between the trustees and the beneficiaries including the personal liability of the trustees to the beneficiaries;

(h) the variation or termination of the trust;

(i) the distribution of the trust assets;

(j) the duty of trustees to account for their administration."

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(ii) that the trust assets shall not form part of the trustee's estate upon its insolvency or bankruptcy; and

(iii) that the trust assets may be recovered when the trustee, in breach of trust, has mingled the trust assets with its own property or has alienated trust assets. However, the rights and obligations of any third party holder of the assets shall remain subject to the law determined by the choice of law rules of the forum.

The Hague Convention Act does not replace otherwise applicable law relating to trusts outside the scope of the Hague Convention Act or the consequences of recognition beyond those set out in the Hague Convention Act.

(f) **Scope of the chosen governing law where the Hague Convention Act does not apply**

There is limited authority for the scope of the Australian common law rules relating to the determination of the validity of a trust outside the scope of the Hague Convention Act. If it has been pleaded and proved as a fact (in accordance with Australian procedural and evidential rules) that a law has been chosen to be the governing law of a trust arrangement (or that the parties have voluntarily entered into arrangements that give rise to a trust governed by particular statutory provisions), it is unclear whether the essential characterisation of such an arrangement as a trust must be determined in accordance with the chosen law or Australian Law.

If as a matter of Australian Law the governing law of the arrangement determines whether it should be characterised as a trust, Australian Law will defer to such governing law, which will govern characterisation and validity of the trust.

If, on the other hand, as a matter of Australian Law it fell to the Australian Courts to consider whether an arrangement governed by the laws of a different jurisdiction constitute a trust (as a result of the governing law of the trust not being determinative of the characterisation), the Australian Courts would look to determine what the essential and defining characteristics of a trust are and then ascertain whether the arrangement in question (governed, in the present case, by either New York law in respect of the Relevant Relationship or U.S. Federal law in respect of the Statutory Trusts) has these characteristics.

Characterisation of a trust under Australian Law

We analyse in this section how a trust arrangement whose governing law is determined to be foreign law would be characterised under Australian common law, if it fell to the Australian Courts to determine such a trust arrangement's characterisation (as a result of the governing law of the trust not being determinative of the characterisation).

There is no single definition of a trust under Australian Law that has been widely adopted as definitive. Several definitions have been proposed, each containing various degrees of description of what constitutes a trust under Australian Law. However, what can be described as the hallmark of a trust under Australian Law, is that a person in whom the property is vested is compelled in equity to hold the property for the benefit of another person or for a charitable, or other legally recognised, purpose. The effect and essence of the trust is to divide the incidents of ownership of the property between the trustee and the beneficiary. The legal ownership vests in the trustee but, when a person holds property as trustee, the trustee is treated in equity as taking it subject to the beneficiary's equitable rights. Under Australian common law, the existence of this feature is generally sufficient for the relationship to be described as a trust.[18] A consequence of an asset being held on trust under Australian Law is that the asset does not fall into the general insolvency estate of the trustee but instead is held by the trustee for the beneficiaries of the trust. Consequently, general creditors of an insolvent trustee will have no claim in the insolvency to the assets held on trust. In our view, in respect of a foreign law arrangement that has this effect, an Australian Court is unlikely to seek to alter the proper law of the arrangement as to the administration of the arrangement[19] and is likely to apply the conflicts of law rules applicable to trusts to determine the appropriate governing law of the rights in respect of that arrangement. This is also consistent with the Hague Convention Act definition of a trust referred to in paragraph (b) above, which requires that the assets held on trust constitute a separate fund and are not a part of the trustee's own estate.

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[18] *Jacob's Law of Trusts in Australia* (8th Edition), Chapter 1.

[19] We consider this to be broadly consistent with the principles in *Gosper v Sawyer* (1985) 160 CLR 548 and *Application of Rinehart* [2020] NSWSC 1624.

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It is clear from both the Hague Convention Act and Australian common law that the law that governs the validity of the trust (in this case, the chosen law) determines the nature of the interest of the beneficiary in the trust and the trust property.

Please refer to paragraphs 4.2 to 4.6 of this Part B for our discussion regarding the application of these Australian Laws to the Statutory Trusts and the Relevant Relationship.

3.2 Creation of multiple Statutory Trusts under U.S. Federal law

As discussed in paragraphs 1.5 and 1.12 to 1.24 of the Summary Annex, the CEA and the CFTC's rules with respect to the Customer Funds require the FCM to segregate or set aside Customer Funds based on the Account Classes to which they relate (i.e. U.S. Futures, Cleared Swaps or Foreign Futures). The respective Customer Property Rules for US Futures and Cleared Swaps result in what US federal courts (both district and appellate) and the CFTC have described as a "technical trust" or "specific statutory trust" over the Segregated Funds for each such Account Class.

We understand that, since the 2013 amendments, the Customer Property Rules for Foreign Futures are substantially similar to the Segregation Rules for funds maintained in the other two Account Classes. The S&C Memorandum concludes that due to the substantial similarities of the three customer property regimes resulting from the 2013 amendments and applying the reasoning from cases in which the courts have found statutory trusts in other regulatory frameworks, there is a strong argument that a separate statutory trust is also established over Foreign Futures Customer Funds.

It is our understanding from reading paragraphs 1.21 to 1.23 of the Summary Annex and Section VII of the S&C Memorandum that it is not wholly without doubt that the Customer Property Rules for Foreign Futures have the effect of imposing a statutory trust over Foreign Futures Customer Funds. We understand that the overarching reason for these strong arguments is that the rules and regulations governing the Separate Account "parallel" the Segregation Rules with respect to the Segregated Funds Account for which definitive statutory trusts exist.[20] These parallels include, among other things, requiring that Foreign Futures Customer Funds be recognized as "belonging to" Foreign

[20] See page 58 and Section VII of the S&C Memorandum.

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Futures Customers, prohibiting the FCM from commingling Foreign Futures Customer Funds in the Separate Account with its own funds, except as expressly permitted, and prohibiting the use of one Foreign Futures Customer's Funds to purchase, margin or settle the trades, contracts, or commodity options of, or to secure or extend credit to, any person other than such Foreign Futures Customer. However, if, as a matter of U.S. Federal law, it were found not to be the case that such a statutory trust exists over Foreign Futures Customer Funds, notwithstanding the foregoing, then the Foreign Futures Customer Funds would amount to property that is subject to a first priority security interest, lien, and right of set-off in favour of the FCM as granted by the Customer pursuant to the Covered Agreement.[21]

In light of the above, our analysis in paragraph 4.3 below in relation to the Statutory Trusts is based on the assumption in paragraph 6(p) of Part A that under U.S. Federal law a separate Statutory Trust is established over the Customer Funds held by the FCM for the benefit of its customers for each Account Class. However, it also refers to relevant considerations under Australian Law if, as a matter of U.S. Federal law, it were found not to be the case that such a statutory trust exists over Foreign Futures Customer Funds.

3.3 Application of the Hague Convention Act or the common law to the Relevant Relationship and the Statutory Trusts

(a) In the case of the Relevant Relationship:

(i) there are good arguments that the Relevant Relationship:

(A) falls within the definition of a "trust" under the Hague Convention Act as the Customer Transactions are placed under the control of the FCM[22] for the benefit

[21] See paragraph 1.36 of Summary Annex and Section X of S&C Memorandum.

[22] As the legal title-holder of the Customer Transactions, the FCM arguably has control of the Customer Transactions (which it holds for the benefit of the Customers). We note however, that unlike a classic trustee, in its capacity as "agent-trustee", the FCM holds legal title to the Customer Transactions "subject to the control of its principal" (see footnote 12 of the Summary Annex), which reflects the nature of the agency relationship between the parties. Although this may on the face of it appear to contradict the Hague Convention Act requirement, we think the better interpretation of this is that the FCM has control over the Customer Transactions but its rights as legal title-holder are fettered by the Customer's right to direct the FCM in respect of the Customer Transactions pursuant to the provisions of the Clearing Agreement and we note from paragraph 3.1.2 of this Hague Convention that "*[t]he*

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of a Customer and the Relevant Relationship is consistent with each of the three characteristics contained within the definition set out in paragraph 4.1(b) of this Part B;[23]

(B) is "created voluntarily and evidenced in writing" for the purposes of the Hague Convention Act, on the basis of our understanding that the Relevant Relationship only arises if the Clearing Agreement is entered into and that some terms of the Relevant Relationship are evidenced in writing in the Clearing Agreement, including that, to the extent that the Transactions carried by the FCM for the Customer generate profits, the FCM is required to account for those profits to the Customer;

(ii) if the Hague Convention Act is applicable, it would provide that New York law would be recognised as the governing law of the Relevant Relationship by an Australian Court; and

(iii) as there is some uncertainty that the Relevant Relationship would fall within the scope of the Hague Convention Act, we also consider its recognition under Australian common law principles. If the Australian common law principles provide that Australian Law would look to the law governing an arrangement to determine its characterisation, then such principles would provide that New York law is recognised as the governing law of the Relevant Relationship by an Australian Court and would also govern its characterisation. However, for completeness, we set out in paragraph 4.4(a) of this Part B our analysis if

reservation by the settlor of certain rights and powers … are not necessarily inconsistent with the existence of a trust" (although this view is not free from doubt).

[23] The trustee's fiduciary obligations (owed as trustee, as opposed to fiduciary obligations owed in any other capacity) appear to be a core feature of an in-scope trust for the purposes of the Convention (see Paragraph 40 of the Explanatory Note to the Hague Convention). As the Hague Convention Act implements the Convention, Australian courts may decide to apply the same construction while analysing trust arrangements under the Hague Convention Act. We understand from the Summary Annex that the fiduciary obligations owed by the FCM to the Customer arises under the agency relationship rather than the trust relationship. This may weaken the argument in favour of the Relevant Relationship being a type of Hague Convention Act trust, notwithstanding that on the face of it, the three characteristics contained within the definition set out in paragraph 4.1(b) of this Part B appear to be met.

the Australian common law principles provide that Australian Law would determine the characterisation of the Relevant Relationship instead.

(b) In the case of each Statutory Trust:

(i) noting our comments in footnote 32 below, the Statutory Trust clearly falls within the definition of a "trust" under the Hague Convention Act as the assets are similarly placed under the control of the FCM for the benefit of a Customer and the Statutory Trust is consistent with each of the three characteristics contained within the definition set out in paragraph 4.1(b) of this Part B;

(ii) as noted above, it is not certain that trusts created by statute can be considered to have been created voluntarily (within the meaning of the Hague Convention Act) and would therefore fall within the Hague Convention Act;

(iii) if the Hague Convention Act is applicable, it would provide that U.S. Federal law is recognised as the governing law of the Statutory Trust by an Australian Court; and

(iv) as it is not certain that the Statutory Trust would fall within the scope of the Hague Convention Act, we also consider its recognition under Australian common law principles. If the Australian common law principles provide that Australian Law would look to the law governing an arrangement to determine its characterisation, then such principles would provide that US Federal law is recognised as the governing law of the Statutory Trust by an Australian Court and would also govern its characterisation. However, for completeness, we set out in paragraph 4.4(b) of this Part B our analysis if the Australian common law principles provide that Australian Law would determine the characterisation of the Statutory Trust instead.

3.4 Application of the definition and features of a trust under Australian Law to the Relevant Relationship and Statutory Trusts

(a) Applying the characteristics of a trust under Australian Law discussed in paragraph 4.1(f) of this Part B above to the Relevant Relationship, the following observations can be made:[24]

(i) the FCM holds legal title to the Customer Transactions credited to a Customer Account;

(ii) the Customer is the beneficial owner (i.e. the owner in equity) of the Customer Transactions credited to the omnibus customer positions account, being entitled to the benefit and subject to the burden of the Customer Transactions;

(iii) Customer Transactions are identified by way of book-keeping records of the FCM as belonging to each Customer;[25]

(iv) Customer Transactions do not form part of the FCM's general estate on insolvency;[26]

(v) after the default of a Customer (and in certain non-default circumstances set out in the Clearing Agreement as well), although the FCM may deal with Customer Transactions without regard to the directions of the Customer, the proceeds arising from the Customer Transactions immediately become part of the Segregated Funds or Separate Account Funds (as applicable) and the FCM must account to the Customer for its entitlement in respect of the Segregated Funds or Separate Account Funds (as applicable); and

(vi) the arrangement is an agency relationship under which the Customer Transactions are held on a trust under New York law, which we understand includes trust law concepts similar to those in Australia.

It appears from the above that the incidents of ownership of the Customer Transactions are split between the FCM and the Customer and, more broadly, the features of this split in incidents of

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[24] In relation to these observations, see Section VI.A. of the S&C Memorandum.

[25] See our assumption in respect of this point at paragraph 6(k) of Part A above.

[26] See our assumption in respect of this point at paragraph 6(m) of Part A above and footnote 32 below.

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ownership are consistent with the characteristics of a trust under Australian Law set out above. Therefore, to the extent not covered by the Convention, while there is no clear Australian case law on the point, an Australian Court is likely to regard the Relevant Relationship as a trust for the purpose of applying the conflicts of law rules to determine the appropriate governing law of the Relevant Relationship and, in doing so, determine that New York law is recognised as the governing law of the Relevant Relationship. This recognition would also be likely to include recognition of proprietary rights which are established under that governing law.[27]

(b) Applying the same principles to each Statutory Trust, the following observations can be made (noting our additional comments below regarding Foreign Futures Customer Funds):[28]

(i) the FCM holds legal title to (a) the Segregated Funds credited to the Segregated Funds Account and (b) the Separate Account Funds credited to the Separate Account (as applicable);

(ii) each Customer has a beneficial interest in (a) the Segregated Funds held in the Segregated Funds Account and (b) the Separate Account Funds credited to the Separate Account, to the extent of the Net Liquidating Equity;[29]

(iii) funds equivalent to the Net Liquidating Equity for each Customer are identified by way of book-keeping records of the FCM as belonging to such Customer;[30]

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[27] We consider this to be consistent with *Damberg v Damberg* [2001] NSWCA 87, in which Australian law trust-based proprietary remedies were applied to rights and obligations established by dealings in Germany under German law, as well as *Hardon v Belilios* [1901] AC 118.

[28] In relation to these observations, see Section VI.B of the S&C Memorandum.

[29] We understand that the beneficial interest of each Covered Customer in respect of the Segregated Funds and Separate Accounts Funds is to the extent of its Net Liquidating Equity in the Customer Account and if the Segregated Funds in the Segregated Funds Accounts or the Separate Account Funds in the Separate Account (as applicable) exceeds the aggregate positive Net Liquidating Equities for Customers of the same Account Class having a beneficial interest in the Segregated Funds Account or Separate Account (but with no reduction for any negative Net Liquidating Equities that Customers may have), the FCM has a Residual Interest in the Segregated Funds and the terms of the Statutory Trusts permit the FCM to withdraw funds from the Segregated Funds or the Separate Account Funds (as applicable) (including for its own proprietary uses) up to the value of that excess.

[30] See our assumption in respect of this point at paragraph 6(k) of Part A above.

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(iv) Segregated Funds and Separate Account Funds are segregated from the FCM's assets (arguably, other than in respect of the Residual Interest the FCM maintains in the Segregated Funds Account and Separate Account to prevent under-segregation);[31]

(v) neither the Segregated Funds nor Separate Account Funds form part of the FCM's general estate on insolvency;[32]

(vi) after the default of a Customer, although the FCM may deal with Customer Funds without regard to the directions of the Customer, the FCM must account to the Customer for the Net Liquidating Equity; and

(vii) the arrangement with respect to each Account Class is characterised as a trust relationship under U.S. Federal law, which we understand includes trust law concepts similar to those in Australia (subject to our comments below in respect of the Foreign Futures Customer Funds).

It appears from the above that the incidents of ownership of the Customer Funds are split between the FCM and the Customer under each Statutory Trust and, more broadly, the features of this split in incidents of ownership are consistent with the definitions of a trust under Australian Law set out above. Therefore, to the extent not covered by the Hague Convention

[31] This is an exception to the requirement under the Customer Property Rules for the FCM to maintain funds belonging to customers segregated from its own assets. The fact that the FCM's Residual Interest may be held in the same account as the Customer Funds does not necessarily preclude the characterisation of the arrangement as a trust provided that the other aspects of the arrangement point towards a trust. See *Stephens Travel Service International Pty Ltd v Qantas Airways Ltd* (1988) 13 NSWLR 331, and United Kingdom authorities *Re Lehman Brothers International (Europe)* [2009] EWHC 2545 (Ch) and *Re Lehman Brothers International (Europe)* [2010] EWHC 2914 (Ch). In addition, the FCM does not beneficially own any specific Segregated Funds or Separate Account Funds relating to its Residual Interest, so it is equally arguable that the Segregated Funds and Separate Account Funds are segregated from the FCM's assets.

[32] See our assumption in respect of this point at paragraph 6(n) of Part A above.

Note we have assumed that Customer Funds are not part of the general estate on insolvency in paragraph 6(m) of Part A above. Our understanding of paragraphs 1.31 to 1.35 of the Summary Annex is that, although Customer Funds do fall within the insolvency estate of the FCM, they fall within a special estate of the FCM (subject to "special distribution rules") that is available for distribution only to Customers entitled to those Customer Funds. In our view, as such Customer Funds are not available for distribution to general creditors of the FCM, they do not fall within the general insolvency estate of the FCM and each Statutory Trust is therefore eligible for recognition as a trust under the Hague Convention and under common law principles.

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Act, while there is no clear Australian case law on the point, an Australian Court is likely, in respect of each Statutory Trust, to apply the conflicts of law rules applicable to trusts to determine the appropriate governing law of each Statutory Trust and, in doing so, determine that U.S. Federal law is recognised as the governing law of each Statutory Trust.

In our view, this conclusion should apply equally even if, as a matter of U.S. Federal law, there is no definitive judgment from a U.S. court as to whether a statutory trust exists over Foreign Futures Customer Funds, provided that the incidents of ownership of the Foreign Futures Customer Funds are split between the FCM and the Customer. In this respect, we understand that U.S. Federal law requires Foreign Futures Customer Funds be recognized as "belonging to" Foreign Futures Customers, prohibits the FCM from commingling Foreign Futures Customer Funds in the Separate Account with its own funds, except as expressly permitted, and prohibits the use of one Foreign Futures Customer's Funds to purchase, margin or settle the trades, contracts, or commodity options of, or to secure or extend credit to, any person other than such Foreign Futures Customer. In other words, absent a clear and authoritative alternative construction of the rights of the FCM and the Customer in respect of the Foreign Futures Customer Funds under U.S. Federal law, we believe that an Australian Court would not seek to alter the proper law of the arrangement as to the administration of the arrangement[33] and would apply the conflicts of law rules applicable to trusts to determine the appropriate governing law of the rights of the FCM and the Customer in respect of the Foreign Futures Customer Funds. This would also be likely to include recognition of proprietary rights which are established under that governing law. However, if, contrary to our instructions and our understanding of the rights of the FCM and the Customer in respect of the Foreign Futures Customer Funds under U.S. Federal law as set out in the S&C Memorandum and Summary Annex, a U.S. court reached a different conclusion as to the characterisation of the substantive rights of the FCM and the Customer in respect of the Foreign Futures Customer Funds under U.S. Federal law (for example, if it is held that the Foreign Futures Customer Funds amount to property that is subject to a first priority security interest, lien, and right of set-off in favour of the FCM as granted by the

[33] We consider this to be broadly consistent with the principles in *Gosper v Sawyer* (1985) 160 CLR 548 and *Application of Rinehart* [2020] NSWSC 1624.

Customer pursuant to the Covered Agreement), then it is possible that an Australian Court may follow the characterisation that the U.S. court adopts on the basis that it would be reluctant to override the construction of the relevant rights under the U.S. Federal law.[34]

On this basis and given our instructions and our understanding of the rights of the FCM and the Customer in respect of the Foreign Futures Customer Funds under U.S. Federal law as set out in the S&C Memorandum and Summary Annex, our analysis in the remainder of this opinion in respect of the Foreign Futures Customer Funds should not be affected merely because, as a matter of U.S. Federal law, there is no definitive judgment from a U.S. court as to whether a statutory trust exists over Foreign Futures Customer Funds.

3.5 Conflict of laws analysis of the trust provisions of the U.S. Clearing Model

Following from the analysis above and on the basis of the assumptions, qualifications and reasoning in this opinion, in our view:

(a) the Relevant Relationship and the Statutory Trusts may fall within the Hague Convention Act;

(b) if either the Relevant Relationship or the Statutory Trusts do not fall within the Hague Convention Act, if the governing law of the trust determines the characterisation and validity of the trust, this will be a matter of New York or U.S. Federal law, respectively; and

(c) if either the Relevant Relationship or the Statutory Trusts do not fall within the Hague Convention Act and the governing law of the trust does not determine the characterisation of the trust, if this falls to be considered by an Australian Court, this characterisation will be a matter of Australian Law and the Australian Court should apply the conflicts of law rules applicable to trusts to determine the appropriate governing law of the Relevant Relationship or Statutory Trust (as applicable) and, in doing so, determine that New York or U.S. Federal law (respectively) is

[34] For example, if a U.S. court holds that the Foreign Futures Customer Funds amount to property that is subject to a first priority security interest, lien, and right of set-off in favour of the FCM as granted by the Customer pursuant to the Covered Agreement then it is possible that an Australian Court may follow this characterisation and approach the rights of an FCM in this regard, and enforcement of them, on the basis of a security interest analysis. In this regard, please refer to our discussion in this opinion in Part E where the close-out netting theory applies and Part G with respect to the exercise by the FCM of its rights as secured party in respect of the Security Interest in Covered Collateral granted by the Customer.

recognised as their governing law of the Relevant Relationship and each Statutory Trust, such that their governing law would determine their validity.

Therefore, if proceedings were brought before the Australian Courts in respect of the Relevant Relationship or the Statutory Trusts and New York law or U.S. Federal law, as applicable, is pleaded and proved as a fact in accordance with Australian procedural and evidential rules, then:

(i) the choice of New York law or U.S. Federal law as the governing law of the Relevant Relationship and the Statutory Trusts, respectively, would be recognised in Australia; and

(ii) accordingly, New York law or U.S. Federal law, as applicable, would govern the validity of the Relevant Relationship and the Statutory Trusts, respectively, and matters affecting the nature of the interest of a Customer in respect of the Customer Transactions held by the FCM on the terms of the Relevant Relationship or the relevant Statutory Trust Property.

The conclusion in this paragraph 4.5 is subject to the following exceptions:

(d) where the Hague Convention Act applies:

(i) the Hague Convention Act does not prevent the application of provisions of the law designated by the conflicts rules of the forum, in so far as those provisions cannot be derogated from by voluntary act, in certain areas related to trusts law;[35]

(ii) the Hague Convention Act preserves the application of the mandatory rules of the forum which must be applied even to international situations, irrespective of conflict of laws, though if another country has a sufficiently close connection with a case then, in exceptional circumstances, effect may also be given to rules of that jurisdiction which have the same character as those mentioned in paragraph 4.5(d)(i);[36] and

[35] Article 15 of the Schedule to the Hague Convention Act.

[36] Article 16 of the Schedule to the Hague Convention Act

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(iii) the provisions of the Hague Convention Act may be disregarded when their application would be manifestly incompatible with public policy;[37] and

(e) where the Hague Convention Act does not apply:[38]

(i) the Australian Courts may not be restricted from applying overriding mandatory provisions of Australian Law; and

(ii) if there is a provision of New York law or U.S. Federal law, as the case may be, that is manifestly incompatible with Australian public policy, it is possible that the Australian Courts may not apply it. However, we are not aware of any relevant incompatibility.

With respect to paragraph 4.5(e)(i) above, there are a number of mandatory provisions that Australian Law would apply in relation to trusts. For example:

(f) in relation to the transfer of title to trust assets and the creation of security interests over trust assets where the *situs* of the trust assets is Australia or where the PPSA otherwise applies; and

(g) Australian Law may require that parties act reasonably or in good faith in their dealings with each other, including, without limitation, in exercising rights, powers or discretions or forming opinions.

However, none of these provisions are directly relevant to the factual circumstances we have been asked to address. Mandatory provisions of Australian Law that apply following commencement of insolvency proceedings are considered in paragraphs 1.2, 3, 4, and 5 of Part D. Whether the Relevant Relationship and the Statutory Trusts give rise to a security interest to which the PPSA applies is considered in paragraph 4.6 of this Part B.

We assume that the terms of the Relevant Relationship and the Statutory Trusts described in the S&C Memorandum would not be manifestly incompatible with Australian public policy. In relation thereto, we are not aware of any relevant incompatibility.

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[37] Article 18 of the Schedule to the Hague Convention Act.

[38] In which case, Australian common law conflict of law rules apply.

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3.6 Risk of characterisation of the Relevant Relationship and Statutory Trusts as security interests under Australian Law

We consider below the potential for the Relevant Relationship and the Statutory Trusts to be characterised as a security interest granted by the Customer in favour of the FCM under the PPSA. We do not consider the Security Interest in this Part B (please see Part G with respect to the Security Interest).

(together "**Insolvency Proceedings**"). These Some relevant aspects of the PPSA are summarised in Schedule 2.

(a) Characterisation of a trustee's right to be indemnified from the trust assets

Amongst other matters, the definition of "security interest" in the PPSA requires a "*transaction that, in substance, secures payment or performance of an obligation*". In our view, the trustee's right to be indemnified from the trust assets does not constitute this.

In our view, the application of the trust assets by the trustee to satisfy its indemnity is not in satisfaction of a subsisting payment obligation or performance obligation. Rather, it is a condition upon which the trustee holds the trust assets and operates as a limitation on the nature of the beneficiaries' assets in the trust. On this analysis, when a trustee uses trust assets to satisfy an indemnity in its favour, the trustee is treating the trust assets as its own assets rather than appropriating the trust assets in satisfaction of an unperformed obligation.[39]

This conclusion is consistent with the analysis of the High Court in *Chief Commissioner of Stamp Duties v Buckle* (1998) 192 CLR 226. This case affirms that it is inaccurate to characterise the acquisition of an interest under a trust containing an indemnity clause as a

[39] Alternatively, it may be said that the trustee's power to deal with trust assets in this fashion does not give rise to a proprietary interest in the trust assets but instead is merely a power a deal with so much of the trust assets as are available for this purpose: *Perpetual Trustees WA v Kelly* (1993) 8 WAR 48.

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transaction whereby the beneficiary creates a security interest in favour of the trustee.[40] The inherent nature of the interest acquired by the beneficiary is already subject to this condition:

> ... the starting point in the class of case under consideration is that the assets held by the trustee are "no longer property held solely in the interests of the beneficiaries of the trust". The term "trust assets" may be used to identify those held by the trustee upon the terms of the trust, but, in respect of such assets, there exist the respective proprietary rights, in order of priority, of the trustee and the beneficiaries. **The interests of the beneficiaries are not "encumbered" by the trustee's right of exoneration or reimbursement.** Rather, the trustee's right to exoneration or recoupment "takes priority over the rights in or in reference to the assets of beneficiaries or others who stand in that situation". A court of equity may authorise the sale of assets held by the trustee so as to satisfy the right to reimbursement or exoneration. In that sense, there is an equitable charge over the "trust assets" which may be enforced in the same way as any other equitable charge. However, the enforcement of the charge is an exercise of the prior rights conferred upon the trustee as a necessary incident of the office of trustee. (emphasis added)[41]

A beneficiary acquires an interest under a trust and accepts that interest as a consequence of the creation of the trust and subject to of the terms of the trust. A beneficiary's interest is, of its very nature, residual, best described as what is left after the trustee has exercised its prior claim.[42]

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[40] We note in this regard obiter dicta of Gordon J in *Carter Holt Harvey Woodproducts Australia Pty Ltd v The Commonwealth* [2019] HCA 20 at [139], which, while not made in the context of considering if either the trustee's right of indemnity or its equitable proprietary interest may constitute a "security interest" for the purposes of the PPSA and which was not necessary to determine the matters the subject of the appeal in that case, may suggest that a security interest involving a transaction arises in the context of a trustee's interest in the trust assets. However, this reasoning was not adopted by the other six judges in the decision. Further, even if this reasoning were adopted in subsequent authorities, we note that sections 8(1)(b) and 8(1)(c) exclude from the operation of the PPSA: (i) a lien, charge, or any other interest in personal property, that is created, arises or is provided for under a law of the Commonwealth (other than the PPSA), a State or a Territory, unless the person who owns the property in which the interest is granted agrees to the interest; or (ii) a lien, charge, or any other interest in personal property, that is created, arises or is provided for by operation of the general law, respectively.

[41] *Chief Commissioner of Stamp Duties v Buckle* (1998) 192 CLR 226 at [50].

[42] *Chief Commissioner of Stamp Duties v Buckle* (1998) 192 CLR 226.

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(b) **The Relevant Relationship and the Statutory Trusts**

We understand from the S&C Memorandum and the Summary Annex that the terms of the Relevant Relationship and the Statutory Trusts do not themselves secure any specific or particular obligation of the Customer to the FCM.

With respect to the Statutory Trusts specifically, we understand from the S&C Memorandum and the Summary Annex that the FCM has, under the terms of the Clearing Agreement as well as the Statutory Trusts, by way of operation of New York law and U.S. Federal law,[43] a right to withdraw funds from the Statutory Trust Property for certain purposes in the circumstances and manner described in the S&C Memorandum and paragraph 1.19 of the Summary Annex. That is, the terms of each Statutory Trust permit the FCM to apply the Statutory Trust Property comprised in the Statutory Trust to enable the FCM to perform its obligations incurred in connection with the Transactions, which are held on the Relevant Relationship. The purpose of each Statutory Trust is, therefore, to enable the FCM to use the Statutory Trust Property either for the purpose of administering the Statutory Trust or for allocating the Statutory Trust to or for the benefit of defined beneficiaries of the Statutory Trust in accordance with the terms of the Statutory Trust. Accordingly, in our view, the Statutory Trust does not, in substance, secure payment or performance of an obligation for the purposes of the definition of "security interest" in the PPSA.

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[43] The S&C Memorandum notes the following:

"Even without the express authorization contained in the Customer Agreement, the Restatement (Second) of Agency provided that:

An agent whose principal violates or threatens to violate a contractual or restitutional duty to him has an appropriate remedy. He can, in a proper case … exercise the rights of a lien holder…" at page 117.

"…under both common law and (we assume) the customer agreement, as well as under Section 4d of the CEA, the FCM has the right, when accounting to its customer, to deduct any advances made from the balance of the customer account" at page 123.

"*The legislative history surrounding the adoption of the safe harbors for commodity contracts in the U.S. Bankruptcy Code supports the conclusions that both the industry and the sponsors of the safe harbors recognized an FCM's ability to enforce its lien against the customer account and set off amount following a customer default*" at page 123.

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In our view, therefore, for the purposes of the PPSA, an Australian Court should not characterise the arrangements under the Relevant Relationship or the Statutory Trusts as a security interest granted by the Customer in favour of the FCM over the Customer Transactions, or Segregated Funds or Separate Account Funds, (as relevant) which are held on the terms of the Relevant Relationship or the relevant Statutory Trust (respectively).

Part C Context regarding the Determination of Account and Liquidation under U.S. Clearing Model

0 Context

We refer to the Determination of Account, pursuant to which, following a Position Liquidation and Margin Liquidation, a single net amount is determined by the FCM after the deduction of any costs and expenses incurred in connection with the liquidation of Customer Transactions or during the course of acting as the Customer's FCM that are permitted by the Customer Property Rules, which is reflected in the balance of the Customer Account and represents the Net Liquidating Equity of the Customer under the Clearing Agreement.

As described in paragraphs 2.10 to 2.14 of the Summary Annex, the determination of a single aggregate credit or debit balance in respect of the Customer Account may be achieved, at the option of the FCM, through a choice of legal methods described in those paragraphs.

In light of this, we consider the analysis of the Determination Account on the basis that, as a matter of all applicable laws (other than Australian law), either the 'trust theory' or 'close-out netting theory', as described below, apply.

Under the '**trust theory**', which is considered in Part D, the contractual and trust relationship between the Customer and the FCM that is evidenced by the Clearing Agreement gives rise to the following:

(a) rights of the FCM to:

() withdraw and apply the Segregated Funds or Separate Account Funds in accordance with the Permitted Uses;

() effect a Position Liquidation or Margin Liquidation; and

(i) determine the following:

() where the Customer's Account includes only one Account Class, a single Determination of Account; or

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(A) where the Customer's Account comprises multiple Account Classes, a separate Determination of Account for each Account Class and, unless the Clearing Agreement provides otherwise, aggregate or offset the credit balances or debit balances of all Account Classes to determine a single aggregate credit or debit balance in respect of the Customer Account (referred to in this opinion as the "**single aggregate balance**");

(b) a duty on the FCM to account to the Customer for the relevant amount referred to in paragraph (iii) above (if such amount is positive); and

(c) an obligation on the Customer to indemnify or reimburse the FCM for the absolute value of the amount referred to in paragraph (iii) (if the amount referred to in (iii) is negative).

Under the '**close-out netting theory**', which is considered in Part E, the Determination of Account (or single aggregate balance, where the Customer's Account comprises multiple Account Classes) is the net amount payable between the FCM and the Covered Customer on the exercise by the FCM of the rights in the Clearing Agreement which allow for contractual obligations under the Clearing Agreement between the FCM and the Covered Customer to be terminated, termination values to be calculated, and for a net amount to become payable (we refer to these rights as the "**Close-out Netting Rights**").

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Part D Analysis in respect of the trust theory

0 Background

0.1 Trust theory

Our analysis in Part D assumes that the trust theory described in Part C applies.

0.2 General Insolvency Principles, Statutory Avoidance Provisions, Specified Stay Provisions and other stays and moratoria

If Australian insolvency proceedings are commenced in respect of the Customer, the question arises as to whether certain transactions which took place before or after the commencement of liquidation or administration of the Customer might be affected by reason of:

(a) the General Insolvency Principles;

(b) the Statutory Avoidance Provisions; and

(c) in the case of an Australian Company which is a Regulated Body or a related body corporate[44] of a Regulated Body, the Specified Stay Provisions, and other stays and moratoria,

(each as defined below).

Before analysing the above, we set out the context in which these rules may be applied.

The General Insolvency Principles and the Statutory Avoidance Provisions apply to transactions entered into by an Australian Company. However, as noted in paragraph 2 of Part B above, a Customer is not a party to the Transactions, which are entered into on a principal-to-principal basis between the FCM and the DCO (or Foreign Futures Broker). Upon a default of a Customer, the liquidation of Customer Transactions (and any related positions) is effected in accordance with the Clearing Agreement, including the rules of each relevant DCO (or the clearing agreement between the

[44] For the purposes of the Netting Act, the question whether a body corporate is related to another body corporate is to be determined in the same way as that question is determined for the purposes of the Corporations Act.

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FCM and its Foreign Futures Broker). In effecting this liquidation, the FCM will be closing out and entering into contractual arrangements and transactions with DCOs (or Foreign Futures Brokers) and other third parties as permitted by the Clearing Agreement and, we understand and have assumed, the FCM will be doing so on its own behalf as principal for its own account and not as agent for the Customer.[45] The Customer will not be closing out or entering into such contractual arrangements and transactions.

As noted in paragraphs 1.10 and 1.11 of the Summary Annex, there are no separate transactions as between the Customer and the FCM. Rather, there is an overall duty of the FCM to account to the Customer for the net amount due under the terms of the Relevant Relationship and the Statutory Trusts. On the assumption that New York law and U.S. Federal law provide that the Customer does not have an interest in any specific Customer Transactions held by the FCM on the terms of the Relevant Relationship or asset that constitutes the relevant Statutory Trust Property, but rather a beneficial interest in such Customer Transactions or relevant Statutory Trust Property (as the case may be) as a whole,[46] Australian Law would not treat the Customer as having an ownership right in any specific Customer Transaction or item of the Statutory Trust Property outright.[47]

As set out in the Summary Annex, following a default by the Customer, the FCM brings about the liquidation of Customer Transactions by way of: (a) Position Liquidation, which may include (i) entering into certain transactions with the DCO (namely, Offsetting Transactions, risk-reducing transactions or hedging transactions and/or any other transaction entered into in order to effect a Position Liquidation (if any)) or (ii) causing the DCO or foreign clearing organisation to debit or otherwise remove the FCM's omnibus customer positions account (or the Foreign Futures Broker's omnibus customer positions account maintained by the foreign clearing organisation) by book-entry transfer of the position to either the FCM's house account or a third party's account, which in either case may be completed as a single position transfer or as part of a transfer of a portfolio of open positions; and (b)

[45] We consider this assumption to be supported by the analysis in Section XI of the S&C Memorandum.

[46] See the assumption in paragraph 6(n) of Part A.

[47] *Stephenson (Inspector of Taxes) v Barclays Bank Trust Co. Ltd.* [1975] 1 W.L.R. 882.

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Margin Liquidation.

Following the determination of the cumulative increase or decrease to the Customer's cash balance resulting from the Position Liquidation and Margin Liquidation (as described in paragraph 2.9 of the Summary Annex), the FCM will determine the Determination of Account payable in connection with the liquidation (which may include its own properly incurred costs and expenses).

As described in paragraph 2.9.1 of the Summary Annex, if the Customer's Account includes only one Account Class, then there is a single Determination of Account. If the Customer's Account comprises multiple Account Classes, then there will be a separate Determination of Account for each Account Class and, unless the Clearing Agreement provides otherwise, the FCM will aggregate or offset the credit balances or debit balances of all Account Classes to determine a single aggregate credit or debit balance in respect of the Customer Account.

1 Application of the Netting Act

Before considering the General Insolvency Principles and the Statutory Avoidance Provisions where the trust theory applies, it is necessary to consider whether the Netting Act will apply, as it provides some protection against the operation of those principles and provisions in certain circumstances. Please see our analysis in Part E below where the close-out netting theory applies.

~~In Part B of this memorandum, we are concerned with the effect of Part 4 of the *Netting Act*, which deals with "close-out netting contracts". A summary of Part 4 of the *Netting Act* is~~ Some relevant aspects of Part 4 of the Netting Act are summarised in Schedule ~~3.~~1.

The foundation of the relevant provisions in Part 4 of the Netting Act is that there is a 'close-out netting contract', the definition of which is considered in paragraph 1 of Schedule 1. As described above, for the purposes of the trust theory, we understand that, under the governing law of the Clearing Agreement (being New York law), there are no separate transactions as between the Customer and the FCM. Rather, there is an overall duty of the FCM to account to the Customer for the net amount due under the terms of the Relevant Relationship and the Statutory Trusts. Further, where the trust theory applies, we understand that the Determination of Account does not involve a termination, close-out netting or set-off of distinct claims under separate transactions, separate from the proprietary

interest of the Customer in the Customer Transactions held by the FCM on the terms of the Relevant Relationship or the Statutory Trust Property.[48]

Further, for the purposes of this Part D, we understand and have assumed that where the trust theory applies, as a matter of all applicable laws (other than Australian Law):

(i) upon the occurrence of an Event of Default under the Clearing Agreement, the FCM is entitled to exercise its contractual rights under the Clearing Agreement to effect a Liquidation;

(ii) the determination of a Customer's Net Liquidating Equity, Determination of Account and determination of a single aggregate credit or debit balance in respect of the Customer Account (where there are multiple Account Classes) by the FCM is merely a computation of a net amount in accordance with the Clearing Agreement, and:

() is not intended to impact, affect, or extinguish the underlying legal obligations or create new legal relationships between the FCM and the Customer; and

(A) does not involve any denial of obligations or acceleration of debt under the Clearing Agreement, close out any transaction relating to the Clearing Agreement or enforcement of security under the Clearing Agreement, nor any set-off.

This is because, as between the FCM and the customer, there are no distinct transactions or obligations that are separate from the overall contractual and trust relationship giving rise to a duty to account either way between the Customer and the FCM that is evidenced by the Clearing Agreement; and

(iii) in withdrawing and applying the Segregated Funds or Separate Account Funds for the purposes established by the statute, the FCM is not foreclosing on or enforcing security over property of the Customer or, indeed, exercising any form of legal set-off, but rather the FCM is applying the Segregated Funds or Separate Account Funds that it holds in the statutory trust created for this purpose in accordance with the terms of the statutory trust to produce a net amount.

[48] See Section XI.A of the S&C Memorandum.

On this basis, where the trust theory applies, we do not consider that a close-out netting contract should be taken to be in place between the Customer and the FCM for the purposes of the Netting Act. Although there can be a single net sum owing to the Customer, the Customer only ever has an entitlement to this single net amount and it does not arise from the contractual termination of obligations owing between the Customer and the FCM under the Clearing Agreement.

For this reason, we do not consider the application of the Netting Act to a Clearing Agreement further in respect of the trust theory, including in this Part D. Please see our analysis in Part E where the close-out netting theory applies.

2 General Insolvency Principles

The immediately following sub-paragraphs (i), (ii) and (iii) set out certain insolvency provisions relevant to the analysis in this Part D, and together, they constitute the "**General Insolvency Principles**".

Taking the General Insolvency Principles in turn:

(i) **(insolvency set-off)** on an Australian Company becoming subject to a winding up, set-off may only occur in accordance with section 553C of the Corporations Act.[49] Section 553C of the Corporations Act permits a right of set-off to apply in the case of mutual credits, mutual debts or other mutual dealings between an insolvent Australian Company that is being wound up and a creditor who wants to have a debt or claim admitted against the Australian Company. Section 553C is mandatory and self-executing.

We assume that the right of the FCM to determine each Determination of Account and the single aggregate balance in respect of all Account Classes forms part of and is an inherent element of the Relevant Relationship and each Statutory Trust and the Customer only ever has

[49] We note that there is some authority to suggest that if section 553C of the Corporations Act has no application in a particular circumstance, it may not operate so as to exclude rights of set-off which would otherwise be applicable under the general law. See *Hamersley Iron Pty Ltd v Forge Group Power Pty Ltd (in liq) (receivers and managers appointed)* (2017) 52 WAR 90 and *Hamersley Iron Pty Ltd v Forge Group Power Pty Ltd (in liq) (receivers and managers appointed)* (2018) 53 WAR 325.

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an entitlement to that single Determination of Account or single aggregate balance (as applicable) in respect of the Relevant Relationship and each Statutory Trust.

As noted in paragraph 2 above, in relation to the Netting Act, whilst this may appear to be a form of netting or set-off, in relation to the Clearing Agreement, the Customer only ever has an entitlement to this single net amount (being either the single Determination of Account or the single aggregate balance). This represents a determination of the overall value of the single course of dealing between the FCM and the Customer rather than the exercise of set off in respect of a number of different transactions – there are no distinct transactions or obligations that are separate from the proprietary interest of the Customer in the Customer Transactions held by the FCM on the terms of the Relevant Relationship or the Statutory Trust Property. On this basis, in our view, section 553C will not be relevant to the Determination of Account or the single aggregate balance and we do not consider it further in this opinion.

(ii) **(*pari passu* rule)** the principle that the unsecured and unsubordinated creditors of an insolvent company are to share equally in the distribution of the company's assets is codified in section 555 of the Corporations Act. As a general matter, contracts which purport to create a different distribution other than in accordance with the provisions of the Corporations Act could be found to be void as being contrary to public policy. Another way that this has been expressed is that such provisions are void as being "in fraud of" the insolvency laws. Under Australian Law, the parties to an agreement cannot contract out of this *pari passu* rule.

It could be argued that the application by the FCM of the Statutory Trust Property to Permitted Uses following the commencement of insolvency proceedings in respect of the Customer where other creditors of the Customer do not recover amounts owed to them in full, would contravene the *pari passu* rule. However, we understand that under applicable U.S. law the Permitted Uses are an inherent element of each Statutory Trust and rank ahead of (because it is determinative of) the Customer's interests in the Statutory Trust Property.[50] The Customer's interest in the

[50] See paragraph 2.15.1 of the Summary Annex, which notes that "[t]o the extent that the applicable Customer Property Rules give rise to a statutory trust for the relevant Account Class, that statutory trust is – by its own terms – subject to the FCM's right to use Customer Funds for Permitted Uses."

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Statutory Trust Property is, therefore, subject to the FCM's right to withdraw funds for Permitted Uses. Therefore, in our view, we consider that the arrangements under the U.S. Clearing Model do not contravene the *pari passu* rule.

(iii) **(anti-deprivation rule)** the anti-deprivation rule is a parallel principle to the *pari passu* rule which states that a person cannot agree that their property will be forfeited or transferred to another, or confiscated, on their insolvency. Similarly, any provisions to the effect that amounts payable by the insolvent party under a contract are increased upon insolvency are unenforceable. The anti-deprivation rule would only be relevant in the context of the U.S. Clearing Model if, on the insolvency of a Customer, the terms on which Customer Transactions are liquidated meant that there was some form of deprivation (e.g. Transactions are taken away from the FCM for no value or a reduced value so as to deprive the Customer's interest in the Customer Transactions held by the FCM on the terms of the Relevant Relationship or Statutory Trust Property of value).

In our view, a Liquidation would not be considered to be a deprivation as there is no property which is forfeited or confiscated or amount payable increased – the Liquidation simply produces a single net amount after the deduction of all costs, expenses and liabilities incurred by the FCM for the account of the Customer that are properly chargeable to the Customer, which is reflected in balance of the Customer Account and represents the Customer's entitlement in respect of the Statutory Trust Property (being the Net Liquidating Equity), which, in any case, is the extent of Customer's beneficial interest in the Customer Transactions or Statutory Trust Property at any point. The anti-deprivation rule was considered in the Supreme Court of England and Wales case of *Belmont Park*[51] where it was held that a "common sense application" of the rule was required in each case. The judgments in *Belmont Park* propose that the correct approach is essentially one of analysing whether or not the arrangements are designed improperly to get around the insolvency principles. The starting point is that a "*deliberate intention to evade the insolvency laws is required*".[52] This is not a purely purposive test – "*that does not mean of*

[51] [2011] UKSC 38.

[52] At paragraph 78.

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course that a subjective intention is required, or that there will not be cases so obvious that an intention can be inferred". But "*a commercially sensible transaction entered into in good faith should not be held to infringe the antideprivation rule.*"[53] "*The Court has to make an objective assessment of the purpose and effect of the relevant transaction or provision in bankruptcy, when considering whether it amounts to an illegitimate evasion of the bankruptcy law or has a legitimate commercial basis in other considerations*". [54] It was also clear that the courts will be slow to strike down "*a complex commercial transaction entered in good faith*"[55]. We have assumed[56] that the arrangements under the U.S. Clearing Model are entered into for *bona fide* commercial reasons and our understanding is that they are not intended to evade insolvency principles. Consequently, we consider that the arrangements under the U.S. Clearing Model do not contravene the anti-deprivation rule.[57]

3 Statutory Avoidance Provisions

3.1 Background

Under Australian insolvency laws, transactions may be void or voidable in certain circumstances, which are summarised in Schedule 6 and are referred to as the "**Statutory Avoidance Provisions**".

3.2 Clawback

In light of our comments in paragraph 1.2 of this Part D and our comments in paragraph 3 immediately above regarding the effect of the Relevant Relationship and the Statutory Trusts, the FCM effecting a Position Liquidation or a Margin Liquidation or calculating the Determination of Account in accordance with the terms of the Relevant Relationship should not, of itself, involve any of the following:

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53 At paragraph 79.

54 At paragraph 151.

55 At paragraph 109.

56 See paragraph 6(f) of Part A.

57 We note that the leading Australian case on this issue, *International Air Transport Association v Ansett Australia Holdings Ltd (2008) 234 CLR 151*, would seem to support this position clearly as there are no rights in respect of which the Customer is being deprived.

(a) a disposition or alienation of property of the Covered Customer or transaction or dealing affecting property of the Covered Customer for the purposes of sections 468 or 437D of the Corporations Act or section 37A of the *Conveyancing Act 1919* (NSW);[58]

(b) the Customer being party to an unprofitable contract which may be subject to disclaimer under section 568 of the Corporations Act (noting that the only contract between the Covered Customer and the FCM is the Clearing Agreement, and it would not be possible for part of it only to be disclaimed);[59]

(c) a transaction to which the Covered Customer is a party which may be set aside under section 588FE of the Corporations Act.[60]

On this basis, in our view, the Australian insolvency laws summarised in Schedule 6 should not be relevant to the Covered Customer in connection with the FCM effecting a Position Liquidation or a Margin Liquidation or calculating the Determination of Account in accordance with the terms of the Relevant Relationship and the Statutory Trusts.

4 Specified Stay Provisions, stays and moratoria

In light of our comments in paragraph 1.2 of this Part D and our comments in Part C above regarding the effect of the Relevant Relationship and the Statutory Trusts, the FCM effecting a Position Liquidation or a Margin Liquidation or calculating the Determination of Account in accordance with the terms of the Relevant Relationship should not, of itself, involve any of the following:

[58] See paragraph 1 of Schedule 5. Sections 468 and 437D of the Corporations Act and section 37A of the *Conveyancing Act 1919* (NSW) apply to dispositions of property of an Australian Company itself. It does not apply to action taken by the FCM to exercise rights in relation to the Customer Transactions or Customer Funds.

[59] See paragraph 2 of Schedule 5.

[60] See paragraph 3.1 of Schedule 5.

(a) the denial of obligations, the acceleration of any debt, or the closing out of any transaction relating to a contract between the Covered Customer and FCM;[61]

(b) the enforcement of any security interest;[62] or

(c) any dealing in relation to any property or asset[63] or debt[64] of the Covered Customer.

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[61] As considered in Schedule 3 and paragraph 2.4 of Part E below, the 'specified stay provisions' in the Industry Acts include stays on a contract itself or a counterparty to a contract denying any obligations or accelerating any debt under, or closing out any transaction relating to, the contract where a regulated body or a related body corporate of a regulated body (in each case, as defined in the Netting Act) is a party in certain circumstances, including due to the fact that the regulated body or related body corporate is subject to statutory management or judicial management. In our view, in light of paragraph 5(a) above, these stays should not adversely affect the Position Liquidation, Margin Liquidation or Determination of Account in accordance with the Relevant Relationship.

[62] As considered in paragraph 4.6 of Part B, in our view for the purposes of the PPSA, an Australian Court should not characterise the arrangements under the Relevant Relationship or the Statutory Trusts as a security interest granted by the Customer in favour of the FCM over the Customer Transactions, or Segregated Funds or Separate Account Funds, (as relevant) which are held on the terms of the Relevant Relationship or the relevant Statutory Trust (respectively).

In our view, in light of this, the following stays should not adversely affect the Position Liquidation, Margin Liquidation or Determination of Account in accordance with the Relevant Relationship:

- section 440B of the Corporations Act, which provides that, during the administration of an Australian Company, no enforcement process in relation to property of the Australian Company can be begun or proceeded with except with the leave of the court or the administrator's consent. Similar stays under the Banking Act, Insurance Act and Life Insurance Act apply with respect to a body corporate during a period in which a statutory or judicial manager is in control of it; and
- as considered in Schedule 4 and paragraph 2.4 of Part E below, the 'specified stay provisions' in the Industry Acts which include stays on enforcing security under a contract to which a regulated body or a related body corporate of a regulated body (in each case, as defined in the Netting Act) is a party in certain circumstances, including due to the fact that the regulated body or related body corporate is subject to statutory management or judicial management.

The FCM's Security Interest in Covered Collateral is considered in Part G.

[63] Section 440D of the Corporations Act provides that, during the administration of an Australian Company, no proceeding in a court or in relation to any property of the Australian Company can be begun or proceeded with except with the leave of the court or the administrator's consent. Similar stays under the Banking Act, Insurance Act and Life Insurance Act apply with respect to a body corporate during a period in which a statutory or judicial manager is in control of it. In our view, in light of paragraph 5(c) above, these stays should not adversely affect the Position Liquidation, Margin Liquidation or Determination of Account in accordance with the Relevant Relationship, on the basis that the Customer has no ownership right in any specific Customer Transactions or Statutory Trust Property outright.

[64] Sections of the Banking Act, Insurance Act, Life Insurance Act and *SIS Act* provide for the application or allocation of assets and the priority of certain debts of an authorised deposit-taking institution, insurer or superannuation entity. In our view, in light of paragraph 5(c) above, these stays should not adversely affect the Position Liquidation, Margin Liquidation or Determination of

On this basis, there should be no such stays on the enforcement of contractual rights against the Covered Customer under Australian Law that would adversely affect the FCM's exercise of its rights to bring about a Position Liquidation and a Margin Liquidation and calculate the Determination of Account, in each case, in accordance with the terms of the Relevant Relationship and Statutory Trusts.

Please see paragraph 5.8 of Schedule 1 with respect to the ipso facto stays which, in our view and on the basis considered in that paragraph, should not be relevant to that Clearing Agreement provided that the Customer Transactions are derivatives.[65]

5 Foreign currency debts

It is also necessary to consider whether, in the event that the FCM determines the Determination of Account in a currency other than Australian dollars, an Australian Court would enforce a claim for such amount in such currency and whether a claim for such amount can be proved in insolvency proceedings in Australia without conversion into Australian dollars.

Where a provable debt or claim against an insolvent company is denominated in a currency other than Australian dollars, then section 554C of the Corporations Act applies. Under section 554C(2), if an insolvent company and the creditor have, in an instrument created before the relevant date, agreed on a method to be applied for the purpose of converting the company's liability in respect of a debt or claim into Australian currency, the amount of the debt or claim that is admissible to proof in the winding up is the equivalent in Australian currency of the amount of foreign currency, worked out as at the relevant date and in accordance with the agreed method.

If such an agreement is not in place, then, under section 554C(3) the amount of the debt or claim that is admissible to proof in the winding up is the equivalent in Australian currency of the amount of

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Account in accordance with the Relevant Relationship on the basis that the Customer has no ownership right in any specific Customer Transactions or Statutory Trust Property outright.

65 As defined in Chapter 7 of the Corporations Act.

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foreign currency, worked out by reference to the opening carded on demand airmail buying rate in relation to the foreign currency available at the Commonwealth Bank of Australia on the relevant date.

Hence, whether or not the FCM has in place an agreement with the defaulting Customer as to currency conversion for these purposes, section 554C provides a mechanism by which, upon insolvency of the Customer, conversion can take place by reference to the relevant date for the purposes of proof in the winding-up.

Note, however, that section 554C does not apply where it is the insolvent company's claim against the creditor which is denominated in a foreign currency. In this situation, the common law would operate. As in England, there appears to be no case law on this point. Having regard to the principles in *Re Dynamics Corporation of America (in liquidation)* [1976] 1 WLR 757, which have been applied in this country (see *Re Gresham Corporation Pty Limited* (1989) 15 ACLR 461) and also approved by the House of Lords in *Stein v Blake* [1996] AC 243, we think it is likely (although we have been unable to find authority to this effect) that conversion would be effected at the commencement of the winding up — that is, at the relevant date — and at a rate applicable at that day which as far as possible would be the same rate applied in relation to claims against the Customer. Accordingly, if the exchange rate in respect of a claim by the FCM against the Customer was at the rate determined pursuant to the Clearing Agreement, then it is likely that a court would apply (in a manner consistent with the principles underlying section 554C) a similar rate in respect of the conversion of claims by the Customer against the FCM.

The above will apply to any single net amount determined to be due from a Customer to the FCM and will not affect the liquidation mechanics of the Clearing Agreement.

Part E Analysis in respect of the close-out netting theory

0 Background

0.1 Close-out netting

Our analysis in Part E assumes that the close-out netting theory described in Part C applies and that, as a matter of New York law and U.S. Federal law, the Determination of Account (or single aggregate balance, as applicable) is the net amount payable between the FCM and the Covered Customer on the exercise by the FCM of Close-out Netting Rights[66] in accordance with the Clearing Agreement.

You have asked us to assume for the purposes of this Part E that the entry into Covered Transactions gives rise to rights and obligations between the Covered Customer and the FCM governed by the Clearing Agreement and that Close-out Netting Rights apply to these obligations (even if those rights and obligations between the Covered Customer and the FCM arise from transactions entered into by the FCM on behalf of the Covered Customer). This assumption is fundamental to parts of the analysis provided in this analysis in connection with the Close-out Netting Rights.

In this Part E, we make no comment on any rights other than Close-out Netting Rights. For example, we do not comment on:

- any duty to account either way between the customer and the FCM under the Relevant Relationship, which is considered in Part D above;
- any rights of the FCM as a secured party, which are considered in Part G below; or
- any other dealing with any proprietary interests.

[66] As noted in in paragraph 1 of Part C above, the term "Close-out Netting Rights" refers to rights of the FCM under the Clearing Agreement which allow for contractual obligations between the FCM and the Covered Customer under the Clearing Agreement to be terminated, termination values to be calculated and for a net amount to become payable.

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1 Application of the Netting Act

1.1 Netting Act

In this opinion, we are only concerned with the effect of Part 4 of the Netting Act, which deals with 'close-out netting contracts', some relevant aspects of which are summarised in Schedule 1.

The foundation of the relevant provisions in Part 4 of the Netting Act is that there is a 'close-out netting contract'. The key part of the definition of a 'close-out netting contract' in the Netting Act is:

Close-out netting contracts

The *Netting Act* applies to contracts which are close-out netting contracts as defined in the *Netting Act*. A close-out netting contract is:

(a) "a contract under which, if a particular event happens:

(i) particular obligations of the parties terminate or may be terminated; and

(ii) the termination values of the obligations are calculated or may be calculated; and

(iii) the termination values are netted, or may be netted, so that only a net cash amount (whether in Australian currency or some other currency) is payable; *or*"

(b) a contract declared by the regulations to be a close-out netting contract for the purposes of this Act;

but does not include:

(c) a contract that constitutes, or is part of, an approved netting arrangement; or

(d) a contract in relation to which a declaration under section 15 is in force; or

(e)a contract declared by the regulations to not be The relevant protections of the Netting Act, including in relation to special protection granted on the enforcement of security, are only applicable if there is a close-out netting contract *for the purposes of this Act*.

Subsection (c) is designed to prevent overlap with other sections of the *Netting Act* dealing with multi-lateral netting arrangements used by Australian clearing banks and approved by the Reserve Bank of

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Australia. These other sections are inapplicable to the Covered Base Agreement and CDA. Subsections (d) and (e) are designed to provide a mechanism for specific contracts to be executed either by a declaration by the Reserve Bank of Australia (on the basis of risk of systemic disruption) or by regulation passed under the *Netting Act*. After inquiry we are not aware of any such declarations or regulations.[9]

In order to constitute a 'close-out netting contract', it is necessary that the Covered Base Clearing Agreement and Futures Covered Transactions together, and the CDA and Cleared Derivatives Transactions together, each form a single bilateral agreement between the Covered Customer and the Clearing Member FCM under all applicable laws. In order for the close-out netting effected through the Futures Liquidation Rights, Futures Netting Rights, Cleared Derivatives Liquidation Rights and Cleared Derivatives Close-out Netting Rights to be protected by the Netting Act, it must operate on obligations which are owing between the parties under that contract. However, it is not necessary that they be "mutual" in the sense of owing between them in the same capacity. This is in contrast to insolvency set-off (see paragraph 1 of Schedule 5).

In accordance with the Instruction Letter, we understand that under the FCM clearing model, the ultimate counterparties to a Covered Transaction that has been novated through the clearing process are (i) the Covered Customer and (ii) each DCO that has accepted the Covered Customer's Covered Transactions for clearing. We also understand that the Cleared Derivatives Payment Rights and Futures Payment Rights may comprise payment obligations of a DCO and, in the case of the Futures Payment Rights, a foreign Clearing Member or foreign clearinghouse. We assume that despite this, the entry into Covered Transactions does still give rise to rights and obligations between the Covered Customer and the Clearing Member governed by the Covered Base Agreement and the CDA and that the Futures Liquidation Rights, Futures Netting Rights, Cleared Derivatives Liquidation Rights and Cleared Derivatives Netting Rights apply to these obligations (even if those rights and obligations between the Covered Customer and the Clearing Member arise from transactions entered into by the

[9] In addition, the 1998 *Explanatory Memorandum* provides that: "It is envisaged that the Reserve Bank would make a declaration under [section] 15 in only the most exceptional circumstances".

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Clearing Member on behalf of the Covered Customer). This assumption is fundamental to parts of the analysis provided in this memorandum.

It Further, it is not necessary for a contract to use the precise words of the definition of close-out netting contract in order for it to be a close-out netting contract.

In *Opes Prime,*[1067] Finkelstein J held that the Australian standard-form securities lending agreement comprises a close-out netting contract on the following basis:

> "In my view, clause 7.4 results in the SLA being a close-out netting contract as defined in s 5 of the Netting Act for the following reasons.
>
> To satisfy the requirements of s 5, certain things must occur in specified circumstances. First, netting must be triggered on the happening of 'a particular event'. Here, the operation of cl 7.4 is triggered by an event of default. An event of default is "a particular act". Once cl 7.4 comes into operation, "the Parties' delivery and payment obligations [are] accelerated" and must be performed on the day the event of default occurred (the performance date). But the clause does not require actual performance of those obligations. Instead, each obligation must be given its "Relevant Value" as at the performance date. "[E]ach Party's claim against the other ... equals the Relevant Value [of the claim]". No payment is required. Instead, "the sums due from one Party [are to be] set-off against the sums due from the other" and only the balance is payable.
>
> Coming back to the definition contained in cl 6, the delivery obligation has been "terminated", in the sense that the obligation has come to an end as required by para (a)(i) of s 5 of the Netting Act. I appreciate that the word "terminate" is a troublesome word and can bear different meanings dependent upon the context. When the inquiry is whether a contractual obligation terminates in this context, however, it can only bear the meaning I have ascribed to the word--namely, the meaning that the obligation has come to an end by being accelerated and liquidated (ie converted into a money debt). The "Relevant Value" which cl 7.4 requires to be given to the "terminated obligations" is the

[1067] *Lindholm, Re Opes Prime Stockbroking Ltd (Admins appointed) (Receivers and managers appointed)* (2008) 171 FCR 473; [2008] FCA 1425.

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"termination value" referred to in para (a)(ii) of s 5. The requirements of cl 7.4 that termination values be set off against each other, satisfies para (a)(iii)."

None of the Futures Liquidation Rights, Futures Netting Rights, Cleared Derivatives Liquidation Rights and Cleared Derivatives Netting Rights are governed by the laws of the Australian Jurisdictions. Accordingly, the construction of the rights created under them is not a question of Australian law. However, it appears that the Futures Liquidation Rights, Futures Netting Rights, Cleared Derivatives Liquidation Rights and Cleared Derivatives Netting Rights comprise the rights which give rise to a "close-out netting contract", taking into account the judicial discussion described above. This is because it appears that the effect of each of these Futures Liquidation Rights, Futures Netting Rights, Cleared Derivatives Liquidation Rights and Cleared Derivatives Netting Rights is that, following an Event of Default in respect of the Australian Company:

- particular obligations, including obligations in respect of any cash Eligible Collateral held in an account that is absolutely transferred from the Covered Customer to the Clearing Member, are terminated in the sense of the obligation coming to an end by being accelerated and liquidated (ie converted into a money debt);

This opinion is given on the basis that the Clearing Agreement is governed by the laws of New York. Accordingly, the construction of the rights created under it is not a question of Australian law. For the purposes of this Part E, we assume that, as a matter of all applicable laws, the Clearing Agreement includes Close-out Netting Rights with the following effect:[68]

(a) particular contractual obligations between the FCM and the Covered Customer terminate. For example, such obligations could include:

(i) in relation to a Position Liquidation, the FCM's obligation to pay the trading gains on the Customer's Covered Contracts to the Customer and the Customer's obligation to

[68] See paragraph 2.13 of the Summary Annex.

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indemnify the FCM against any trading losses or other costs or losses incurred in carrying out that activity);[69] and

(ii) in relation to a Margin Liquidation, the FCM's obligation to pay the amount of the liquidation proceeds or values of the Customer Funds credited to the relevant Account;

(b) upon being terminated, the terminated obligations are given a value. For example:

(i) ~~•upon being terminated,~~ the amount of the cumulative trading gains and losses upon Position Liquidation by the FCM could be viewed as the determination of the termination value of the terminated obligations ~~are given a value; and~~of the FCM and the Customer in respect of the Covered Contracts; and

(ii) the amount of the liquidation proceeds or values of the Customer Funds credited to the relevant Account upon a Margin Liquidation could be viewed as the determination of the termination value of the terminated obligations of the FCM and the Customer in respect of those Customer Funds; and

(c) ~~•~~the termination values are netted against each other so that only a net cash amount is payable~~.~~ between the parties, being:

(i) where the Customer's Account comprises one Account Class, the single Determination of Account in respect of that Account Class, or

(ii) where the Customer's Account comprises multiple Account Classes, a single aggregate balance in respect of all the Account Classes.

If this is a correct interpretation of the ~~Futures Liquidation Rights, Futures Netting Rights, Cleared Derivatives Liquidation Rights and Cleared Derivatives Netting Rights under their governing law, on the bases~~ Clearing Agreement under its governing law on the basis set out above, then the ~~Covered Base~~ Clearing Agreement ~~and CDA~~ should be a close-out netting contract for the purpose of the Netting Act.~~In this paragraph, we make no comment on any rights which comprise the Futures Netting~~

[69] See paragraph 2.4(1) of the Summary Annex.

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Rights and Cleared Derivatives Netting Rights which extend beyond contractual rights providing for the calculation and netting of termination values of the obligations under the Covered Base Agreement or CDA (as applicable) which have been terminated (such as rights as a secured party).

1.2 External administration

Each of the Insolvency Proceedings referred to in paragraph 3.2 of Part A to which an Australian Company may be subject falls within the definition of "external administration"[11] in the Netting Act.[12][70]

Section 14(2)(c) of the Netting Act provides that, in respect of a close-out netting contract, where a party goes into external administration and Australian law governs either the external administration or the contract:

- obligations under the close-out netting contract may be terminated;
- termination values may be calculated; and
- a net amount become payable,

in accordance with the close-out netting contract.

---

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

(a) they become a body corporate that is a Chapter 5 body corporate within the meaning of the *Corporations Act 2001*; or

(b) they are an individual who is an insolvent under administration; or

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

(d) an ADI statutory manager takes control of the person's business under the [*Banking Act*]; or

(e) the person comes under judicial management under the [*Insurance Act*]; or

(f) the person, or a part of the person's business, comes under judicial management under the [*Life Insurance Act*]."

The reference to "a Chapter 5 body corporate" in section 5 of the *Netting Act* replaced a reference to "an externally administered body corporate" on commencement of the relevant part of the *Insolvency Law Reform Act 2016* (Cth) on 1 March 2017.

[12][70] In the case of a trustee of a superannuation entity, the appointment of an acting trustee because the trustee of the superannuation entity is, or is likely to become, insolvent, will fall within the definition of "external administration". However, if such an acting trustee is appointed for other reasons and the trustee of the superannuation entity is not insolvent, or likely to become insolvent, we consider that the Netting Act would not apply. This is discussed in further detail in paragraph 8 of Schedule 2 to this memorandum.

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Consequently, to the extent that these rights are exercised and exercised in accordance with the terms of the Futures Liquidation Rights, Futures Netting Rights, Cleared Derivatives Liquidation Rights and Cleared Derivatives Close-out Netting Rights, the exercise of these rights by the Clearing Member FCM should be protected by the Netting Act on an external administration of the Covered Customer governed by Australian law, provided that neither section 14(4) nor section 14(5) of the Netting Act applies to the contract and subject to any specified stay provision which applies to the contract. Sections 14(4) and 14(5) of the Netting Act provide that a person may not rely on section 14(2) in certain circumstances (see paragraphs 5.1 and 5.2 of Schedule 1).

In addition, subsections 14(2)(d) to (f) provide that:

- obligations that are, or have been, terminated under the close-out netting contract are to be disregarded in the external administration;
- any net obligation owed by the party under the close-out netting contract that has not been discharged (i) is provable in the external administration; and (ii) may be recovered by the external administrator for the benefit of creditors.
- any net obligation owed to the party under the close-out netting contract that has not been discharged may be recovered by the external administrator for the benefit of creditors.

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

The protection afforded to close-out netting under the *Netting Act* applies despite, relevantly:

- any disposal of rights that may be netted under the contract; or
- the creation of any encumbrance, or any other interest, in relation to those rights; or
- the operation of any encumbrance, or any other interest, in relation to those rights,

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~~in contravention of a prohibition in the contract or the security.[13] The inclusion of this provision was~~ Please see paragraph 3 of Schedule 1 with respect to section 14(2)(g), which is intended to ensure that close-out netting on an external administration is not affected by the interests of third parties which arise in contravention of a prohibition in the contract, subject to any specified stay provision that applies to the contract.[14][71]

~~Sections 14(4) and 14(5) of the *Netting Act* provide that a person may not rely on section 14(2) in certain circumstances (see paragraphs 6.1 and 6.2 of Schedule 3).~~

We express no opinion in this ~~memorandum~~ opinion on the enforceability of any action taken by the ~~Clearing Member~~ FCM or any other person on behalf of the Covered Customer, ~~including the creation of offsetting transactions in the Covered Customer's Account held at the Clearing Member~~and assume that the entry into Offsetting Transactions, risk-reducing transactions or hedging transactions, and/or causing book-entry transfers of Transactions following a Customer default does not involve any action being taken by the FCM on behalf of the Customer, but rather actions taken by the FCM as principal. We consider this assumption to be supported by the analysis in Section XI of the S&C Memorandum. Further, in our analysis in this Part E in respect of the exercise by the FCM of Close-out Netting Rights in accordance with the Clearing Agreement, we express no opinion with respect to transfers of Customer Funds, including, without limitation, for Permitted Uses. However, we note that, where the Covered Customer is insolvent or subject to certain types of Insolvency Proceedings, the authority of the ~~Clearing Member~~ FCM or other person ~~may~~ to act on behalf of the Covered Customer may, as a matter of Australian Law, be revoked with the result that the taking of action on behalf of the Covered Customer may not be enforceable under Australian Law against the Covered Customer. Please see Part G with respect to the exercise by the FCM of its rights as secured party in respect of the Security Interest in Covered Collateral granted by the Customer.

~~[13] Section 14(2)(h) of the *Netting Act*. The term "the security" refers to a security given over financial property, in respect of obligations of a party to the close-out netting contract, and is considered in more detail in Part C of this memorandum. Section 14(2)(h) of the *Netting Act* does not apply to disposals of rights or property, or the creation or operation of encumbrances or interests, before 1 June 2016.~~

[14][71] 2016 Explanatory Memorandum, [1.124].

Please see the following paragraphs with respect to the relationship of section 14(2):

(a) **2.7Relationship** with other law (other than the PPSA and **the specified stay provisions)**the specified stay provisions) – paragraph 5.4 of Schedule 1;

(b) with the PPSA – paragraph 5.5 of Schedule 1; and

(c) with the specified stay provisions – paragraph 3 immediately below and Schedule 4.

1.3 Suitability of valuation methodology

We note that the Explanatory Memorandum to the Payment Systems and Netting Bill 1998 (Cth) states that the Netting Act will not apply to contracts where the mechanism for calculation of the termination value is a "device" to deprive a party of value as follows:

> "A device of the kind used in *Ex parte Mackay* (1883) 8 Ch App 643 would not fall within the definition because it would not reflect any attempt to calculate the true termination value of the obligation under consideration."

Accordingly it is important that the valuation methodology applied pursuant to the Close-out Netting Rights is an appropriate calculation of value and not a contrivance intended to gain an advantage on a party's default.

1.4 Ipso facto stays

Please see paragraph 5.8 of Schedule 1 with respect to the ipso facto stays which, in our view and on the basis considered in that paragraph, should not be relevant to a Clearing Agreement where the Clearing Agreement is a close-out netting contract (noting our conclusion above that the Clearing Agreement should be a close out netting contract for the purpose of the Netting Act, provided our interpretation of the Clearing Agreement under its governing law on the basis set out above is correct).

Section 14(3) of the *Netting Act* provides that section 14(1) and section 14(2) have effect in relation to a close-out netting contract "despite any other law (including the specified provisions)", but subject to any specified stay provision that applies to the Covered Base Agreement or CDA. A specified stay provision which applies to a close-out netting contract will prevent the contract or a counterparty from, relevantly, closing out transactions relating to the contract on the grounds discussed in the

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relevant specified stay provision. However, a specified stay provision does not prohibit a counterparty from closing out Covered Transactions under the Covered Base Agreement or CDA for any other reason. The specified stay provisions are considered in Schedule 4 and the paragraph entitled "Specified stay provisions" immediately below.

The explanatory memorandum published by the Commonwealth Government when the Financial System Legislation Amendment (Resilience and Collateral Protection) Bill 2016 (Cth) was introduced in Federal Parliament ("***2016 Explanatory Memorandum***") explained that the "specified provisions" definition is an inclusive list of the provisions of other laws over which the *Netting Act* prevails and is inserted for transparency and ease of reference. The laws included in the definition of "specified provisions" include laws providing for the following:

- the assets of Australian banks and other authorised deposit-taking institutions being available to meet the obligations to depositors before other creditors (section 13A(3) of the *Banking Act*);
- the assets of foreign authorised deposit-taking institutions in Australia being available to meet Australian liabilities before other liabilities (section 11F of the *Banking Act*);
- the priority of an Australian bank's debts to the Reserve Bank of Australia over the other debts owed by the bank (other than those owed to depositors);
- the allocation of assets of a life company on its insolvency; and
- the winding up or dissolution of trustees of superannuation entities.

Specific reference is also made to the insolvency provisions of the *Corporations Act* (essentially those provisions concerning voidable and void transactions) and certain provisions of the *Bankruptcy Act*. A note is made in the legislation to the effect that the express recognition given to close-out netting in sections 14(1) and 14(2) of the *Netting Act* is to remove the basis for arguing that close-out netting contracts are void as contrary to public policy embodied in insolvency law.

The term "specified provisions" also includes the references to sections of the following Acts:

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- the *Banking Act, Insurance Act* and the *Life Insurance Act.*[15] These provisions were included to clarify that the protections afforded in the *Netting Act* prevail over the regimes set out in those Acts which allow for counterparties under a contract with an ADI, general insurer, or life company (or other specified entity) to be relieved of their obligations under that contract if the regulated entity is prevented from fulfilling its contractual obligations. In other words, the counterparty can close-out transactions under the contract, rather than being merely relieved of their obligations under the contract.[16]
- the PPSA and the *Corporations Act*, which were included to clarify that the protection afforded in the *Netting Act* would prevail over these provisions of those Acts, which may otherwise impose a stay on enforcement of security in certain circumstances (section 440B of the *Corporations Act*), which set out certain priority payments (section 556 of the *Corporations Act*) and which provide for circumstances in which security interests will vest (section 588FL of the *Corporations Act* and sections 267 and 267A of the PPSA).[17]

2 2.8Specified stay provisions

To the extent the Netting Act would permit a party to exercise its Close-out Netting Covered Transactions related to Rights under the Covered Base Clearing Agreement or CDA in accordance with its terms, the protection is subject to any specified stay provision that applies to the Covered Base Clearing Agreement or CDA. Relevantly for this Part B, the "The specified stay provisions" do not allow the close-out of transactions with an Australian Company that is an ADI, a life company or a general insurer due to specified events, and are considered in detail in Schedule 4.

We expect that the most relevant "specified stay provision" in the context of the Covered Base Clearing Agreement or CDA is the stay that applies on the appointment of a statutory manager or the appointment of a judicial manager. This memorandum is given on the basis that the Covered Base

[15] Sections 230C(2) and (3) of the *Life Insurance Act;* sections 105(2) and (3) of the *Insurance Act;* sections 11CD(2) and (3) of the *Banking Act.*

[16] *2016 Explanatory Memorandum*, [1.165].

[17] *2016 Explanatory Memorandum*, [1.167].

Agreement or CDA are governed by the laws of New York and are not governed by Australian law. Accordingly, the construction of the rights created under them is not a question of Australian law. However, is on the basis that we assume that the appointment of a statutory manager or the appointment of a judicial manager would trigger an Event of Default under the Covered Base Agreement or CDA where the Events of Defaults under a Covered Base Agreement or CDA include defaults predicated on the matters described in paragraphs A.2.1(e)(i) to A.2.1(e)(iii) above provided, in the case of a life company, any appointment of a judicial manager is over the life company or substantially all of its assets. However, this depends on the terms of the Covered Base Agreement or CDAClearing Agreement which would otherwise enable the FCM to exercise its Close-out Netting Rights, however, this depends on the terms of the Clearing Agreement. In light of this, we consider the implications of the stay that applies on appointment of a statutory manager or the appointment of a judicial manager further below.

Each specified stay provision only relates to the relevant event described in that specified stay provision. The stay framework does not prohibit a counterparty from closing out Covered Transactions under the Covered Base transactions relating to the Clearing Agreement or CDA for any other reason. For example, to the extent that an Event of Default under the Covered Base Clearing Agreement or CDA has occurred due to an event that is not described in a specified stay provision, then the counterparty may still close out Covered Transactions under the Covered Base transactions relating to the Clearing Agreement or CDA if it has a right to do so in accordance with the terms of the Covered Base Clearing Agreement or CDA due to that Event of Default occurring and continuing.

Duration of stay on the appointment of a judicial manager or the appointment of a statutory manager or judicial manager

The amendments to the Netting Act provide a framework under which the stay on the appointment of a statutory manager or the appointment of a judicial manager may cease where an obligation under the Covered Base Clearing Agreement or CDA is either (i) an eligible obligation or (ii) is of another prescribed kind. These concepts are considered further in paragraph C.I.3.6 below and paragraph 3.1 of Schedule 4.

The stay on closing out Covered Transactions under the Covered Base transactions relating to the Clearing Agreement or CDA on the grounds of the appointment of a statutory manager or the

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appointment of a judicial manager ends at midnight[18][72] at the end of the first business day after the day on which the statutory manager or the judicial manager was appointed (being the end of the "**resolution period**"), unless the Australian Prudential Regulation Authority ("**APRA**") makes a declaration that:

(a) the stay ceases to apply before that time; or

(b) the stay is extended. This may only occur where APRA is satisfied of certain solvency- and licensing-related matters in relation to the party in respect of which the declaration will be made (that party being the ADI, the life company or general insurer in this context) in relation to the trigger body as set out in paragraph 3.3 of Schedule 4. The 2016 Explanatory Memorandum[73] explained that these matters:

> "are intended to reflect international developments such as the [ISDA 2015 Universal Resolution] Stay Protocol as closely as possible, particularly the requirements set out in the elements of paragraph (e) of the definition of 'Protocol-eligible Regime' in the Stay Protocol which relates to any 'Close-out Stay' (as that term is defined in the Stay Protocol), whilst also reflecting concepts recognised in Australian law."[19][74]

If the stay ceases to apply either at the end of the resolution period, or before that time (as referred to in paragraph (a) above), then a counterparty may close-out Covered Transactions under the Covered Base transactions relating to the Clearing Agreement or CDA on the grounds of the appointment of a statutory manager or the appointment of a judicial manager.

The cessation and extension of the stay is considered further in paragraphs 3.1, 3.2 and 3.3 of Schedule 4.

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[18][72] By legal time in the Australian Capital Territory.

[73] References in this opinion to the 2016 Explanatory Memorandum are to the explanatory memorandum published by the Commonwealth Government when the *Financial System Legislation Amendment (Resilience and Collateral Protection) Bill 2016* (Cth) was introduced in Federal Parliament.

[19][74] 2016 Explanatory Memorandum, [1.236] (footnote omitted).

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2.9 Termination of Covered Transactions on the insolvency of the Covered Customer

Are the provisions of the Covered Base Agreement and CDA permitting the Clearing Member to terminate all the Covered Transactions upon the insolvency of the Covered Customer enforceable under the law of your jurisdiction?

For the reasons given in paragraphs A.2.1 and A.2.2 above and immediately below, the provisions of the Covered Base Agreement and CDA permitting the Clearing Member to terminate all the obligations which it owes under the Covered Base Agreement and CDA in respect of Covered Transactions upon an external administration of the Covered Customer governed by Australian law are effective under the laws of the Australian Jurisdictions, subject to any specified stay provision that applies to the Covered Base Agreement or CDA. This right to terminate is expressly permitted under section 14(2)(c) of the *Netting Act*, subject to any specified stay provision that applies to the Covered Base Agreement or CDA.

2.10 Netting of termination values on the insolvency of the Covered Customer

Are the provisions of the Covered Base Agreement and CDA providing for the netting of termination values and cash collateral that is viewed as a title transfer (see discussion in assumption (e) in section 1, Part B of Schedule 1 to this memorandum) in determining a single lump-sum termination amount upon the insolvency of a Covered Customer enforceable under the law of your jurisdiction?

The calculation and netting of termination values, including in respect of any cash Eligible Collateral that is absolutely transferred from the Covered Customer to the Clearing Member, so that only a net cash amount is payable is expressly permitted under section 14(2)(c) of the *Netting Act* upon an external administration of the Covered Customer governed by Australian law, subject to any specified stay provision that applies to the Covered Base Agreement or CDA.

We do not offer any opinion on the adequacy of the valuation methodology applied pursuant to the Futures Liquidation Rights, Futures Netting Rights, Cleared Derivatives Liquidation Rights and Cleared Derivatives Netting Rights. However, the Explanatory Memorandum published by the Commonwealth Government when the Bill to enact the *Netting Act* was introduced in Federal Parliament ("***1998 Explanatory Memorandum***") states that the *Netting Act* will not apply to contracts where the calculation of the termination value is a "device" to deprive a party of value as follows:

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"A device of the kind used in *Ex parte Mackay* (1883) 8 Ch App 643 would not fall within the definition because it would not reflect any attempt to calculate the true termination value of the obligation under consideration."

Accordingly it is important that the calculation of the net termination amount pursuant to the Futures Liquidation Rights, Futures Netting Rights, Cleared Derivatives Liquidation Rights and Cleared Derivatives Netting Rights is an appropriate calculation of value and not a contrivance intended to gain an advantage on a party's default.

2.11 Netting of termination values on the insolvency of the Covered Customer for a foreign currency-denominated net amount

Assuming the parties have entered into a Covered Base Agreement and CDA, the Covered Customer is insolvent and the Clearing Member has determined a lump-sum termination amount in a currency other than the currency of the jurisdiction in which the insolvent party is organized:

(1) would a court in your jurisdiction enforce a claim for the net termination amount in the currency in which it was determined?

(2) can a claim for the net termination amount be proved in insolvency proceedings in your jurisdiction without conversion into the local currency?

If in either case the claim must be converted to local currency for purposes of enforcement or proof in insolvency proceedings, please set out the rules governing the timing and exchange rate for such conversion.

Under section 14(2)(c) of the *Netting Act* the net amount of the termination values is payable in accordance with the contract.

3 Foreign currency

The definition of 'close-out netting contract' in section 5 of the Netting Act makes specific reference to the fact that the net amount owing may be in a currency other than Australian currency. Section 14(2)(c) provides that the net amount is payable "in accordance with the contract". On this

basis the calculation of the Determination of Account in a currency other than Australian dollars under the Clearing Agreement will be validated by section 14(2)(c) of the Netting Act.

Further, under sections 14(2)(e) and (f) of the *Netting Act*, In addition, section 14(2)(e) of the Netting Act provides that any net obligation owed by a party under the close-out netting contract is provable (or recoverable) in the external administration of that the party. Section 14(2)(f) of the Netting Act provides that any net obligation owed to a party under external administration may be recovered by the external administrator for the benefit of the creditors of the party. Subject to the discretion of an Australian Ccourt to award judgements in Australian dollars, section 14(2)(e) this would imply that the net amount calculated in a currency other than Australian dollars is also provable in the external administration of a an insolvent party to the Covered Base Agreement and CDA. However, if the external administration was winding up, such proof would result in significant practical difficulties for a liquidator in ensuring the payment of creditors on a pari passu basis.[75]

As a result, if the operation of the Covered Base Agreement and CDA results in a net amount being payable by a party subject to winding up, then section 554C of the *Corporations Act* will be relevant.Section 554C of the *Corporations Act* requires debts to be proved in a liquidation in Australian dollars at the "relevant date" (which is generally the day the winding up order is made but can be earlier) at either an agreed rate or, in the absence of agreement, a rate set out in the section.

This rule does not prevent the parties to the Covered Base Agreement or CDA from calculating the net termination amount in a currency other than Australian dollars pursuant to the terms of the Covered Base Agreement and CDA. However, the resulting liability will have to be converted into Australian dollars for the purposes of proof at the rate provided for in section 554C of the *Corporations Act* applying on the relevant date.

[75] As stated by Lord Hoffmann in *Stein v Blake* [1996] 1 AC 243, there is a "general principle of bankruptcy law, which governs payment of interest, conversion of foreign currencies etc., that the debts of the bankrupt are treated as having been ascertained and his assets simultaneously distributed among his creditors on the bankruptcy date".

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2.12 Insolvency set-off

If the Covered Base Agreement and Futures Transactions together, or the CDA and Cleared Derivatives Transactions together, do not comprise a close-out netting contract for the purposes of the *Netting Act* as considered in section B.2.6 above, then it is relevant to consider the enforceability of the contractual set-off provided for by the Futures Liquidation Rights, Futures Netting Rights, Cleared Derivatives Liquidation Rights and Cleared Derivatives Netting Rights ("**Contractual Set-off Rights**"). In this paragraph B.2.12, we assume that the Covered Customer is an Australian Company which is either an Australian Bank or is acting in no special capacity.

The analysis of the enforceability of the Contractual Set-off Rights on the external administration of an Australian Company is dependent on the particular Insolvency Proceeding which is applicable. In Schedule 5 to this memorandum we set out a summary of the enforceability of the Contractual Set-off Rights in respect of each Insolvency Proceeding.

In accordance with this analysis, if the Australian Company is:

(a) the subject of winding up, then the set-off under section 553C of the *Corporations Act* will mandatorily and automatically occur if its conditions are satisfied. As mentioned in Schedule 5 to this memorandum, one of the requirements which must be met for set-off under section 553C to operate is that obligations must be mutual. Consequently, there would be no set-off under section 553C of obligations owing under Covered Transactions that are between the Covered Customer and the relevant DCO against obligations between the Covered Customer and the Clearing Member in respect of and related to the novated transactions. [20]Also, if the Australian Company is an Australian Bank, the set-off may be subject to the priorities of depositors and other preferred creditors in accordance with section 13A of the *Banking Act* unless the rights of the Australian Company are located outside of Australia;

(b) the subject of compromise or arrangement with creditors, then the compromise or arrangement should not prevent the exercise of the Contractual Set-off Rights before the

[20] As noted above, this mutuality requirement is in contrast to the requirements under the *Netting Act*.

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time that the compromise or arrangement becomes binding on the creditors of the Australian Company;

(c) the subject of administration, then the appointment of an administrator should not prevent the exercise of the Contractual Set-off Rights provided they are exercised before the deed of company arrangement is entered into. However, the effect of the Contractual Set-off Rights may be subject to the lien of the administrator for its costs incurred following its appointment (this lien may take priority with respect to the amount payable to the Australian Company in administration, reducing the amount available for set-off against the amount payable by the Australian Company);

(d) the subject of statutory management (if the Australian Company is an Australian Bank), then the appointment of the statutory manager may prevent the exercise of the Contractual Set-off Rights if they are exercisable only because the statutory manager has been appointed. Otherwise the appointment of a statutory manager should not prevent the exercise of the Contractual Set off Rights. However, as noted above in paragraph (a) above, the depositor protection provisions of section 13A of the *Banking Act* may interfere with the Contractual Set off Rights, unless the rights of the Australian Company are located outside of Australia;[21] and

(e) the subject of receivership, then the appointment of the receiver should not prevent the exercise of the Contractual Set-off Rights unless the receiver has been appointed to the rights of the Australian Company which are the subject of the set-off (this would require that the Australian Company had granted effective security over those rights).

[21] This depositor priority section of the *Banking Act* applies whenever an ADI is unable to meet its obligations or suspends payment and is not specifically linked to any particular insolvency process. We have specifically referenced it in relation to winding up and statutory management on the assumption that these would be the more likely proceedings to be commenced against an Australian Company which is an ADI (with statutory management most likely to occur first). However, if the conditions for the operation of the depositor priority provisions are satisfied, it could interfere with the Contractual Set-off Rights if other insolvency proceedings have commenced, or if no insolvency proceedings have commenced against the ADI.

Please also see paragraph B.2.8, regarding stays under the specified stay provisions which apply to accelerating any debt under a contract to which an ADI, life company or a general insurer is a party.

2.13 The Personal Property Securities Act

Please see paragraph C.I.2 below with respect to the PPSA.

The two exclusions from the PPSA which are particularly relevant to close-out netting and contractual set-off under the Covered Base Agreement and CDA are:

(a) ***Set-off exclusion:*** section 8(1)(d) provides that the PPSA does not apply to:

"any right of set-off or right of combination of accounts (within the ordinary meaning of the term "accounts")"

(b) ***Close-out netting contract exclusion:*** section 8(1)(e) provides that the PPSA does not apply to:

"any right or interest held by a person, or any interest provided for by any transaction, under any of the following (as defined in section 5 of the *Payment Systems and Netting Act 1998*):

Please see paragraph 6 of Part D regarding whether a claim for a Determination of Account denominated in a foreign currency can be proved in insolvency proceedings in Australia without conversion into Australian dollars.

Part F Responses to questions on Position Liquidation, Margin Liquidation and Determination of Account

In this Part F we address the questions contained in your Instructions in relation to Position Liquidation, Margin Liquidation and Determination of Account, in respect of each of the trust theory and the close-out netting theory. We do not consider in this Part F any rights of the FCM as a secured party, which are considered in Part G.

Each question is set out in italics followed by our response.

The definitions for the following terms used in this Part F are below:

- "**Determination of Account Rights**" means the rights of the FCM to determine the Determination of Account under and in accordance with the Covered Agreement;
- "**Margin Liquidation Rights**" means the rights of the FCM to effect a Margin Liquidation under and in accordance with the Covered Agreement;
- "**Position Liquidation Rights**" means the rights of the FCM to effect of a Position Liquidation under and in accordance with the Covered Agreement, pursuant to which the FCM may close out or otherwise liquidate the Customer's open positions in its Contracts, and hedge risk incurred by the FCM in connection with such Event of Default, by any reasonable method, including by means of entering into Offsetting Transactions, risk-reducing transactions or hedging transactions and/or causing book-entry transfers, and by valuing any transactions entered into by the FCM ("**Position Liquidation**").[76]

[76] See paragraphs 2.4 and 2.5 of the Summary Annex and Section XI of the S&C Memorandum.

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0 Position Liquidation, Margin Liquidation and Determination of Account

0.1 *Question 1: Would the parties' agreement on governing law and submission to jurisdiction set out in each of the Base Account Agreement and CDA be given effect by a court be upheld in your jurisdiction, and what would be the consequences if they were not?*

Please see our discussion in respect of this point in paragraph 3.1 of Part B above, including that, in any proceedings properly commenced by a party in an Australian Court claiming enforcement of a Base Account Agreement and CDA governed by New York law, the Australian Court will give effect to the choice of New York law as the governing law of the Base Account Agreement and CDA but will apply the relevant procedural laws and other laws of the relevant Australian Jurisdictions which apply regardless of the choice of law.

If the parties' agreement on the governing law and their submission to jurisdiction were not upheld (although we believe it would), the Base Account Agreement and CDA would be examined on the basis of the law determined to be most applicable by an Australian Court. These types of proceedings are unusual and it is difficult to be precise about rules a court will adopt because much depends on the facts and the court has a wide discretion.

0.2 *Question 2: Would the Position Liquidation provisions of each of the Base Account Agreement and the CDA be enforceable under the laws of your jurisdiction and each of the Position Liquidation methods described in Section XI of the S&C Memo and paragraph 2.4 of the Summary Annex, be recognized and upheld by a court in your jurisdiction? If a particular method would either not be upheld or may be challenged, please provide further detail and explain the reason for this.*

Trust theory

Where the trust theory applies then, subject to and as considered in paragraph 4 of Part B, in our view, the Relevant Relationship would be recognised under Australian Law as a trust for the purpose of determining the appropriate governing law of the Relevant Relationship and New York law would be recognised as the governing law of the Relevant Relationship. This recognition would include recognition of the validity, interpretation and effect of proprietary rights of the FCM which are established by the Relevant Relationship under New York law to administer or to dispose of the

relevant Customer Transactions. Please see our response in paragraph 1.3 immediately below regarding the nature of the Customer's interest in respect of the Customer Transactions.

Accordingly, assuming that the Position Liquidation Rights described in paragraph 2.4(1) of the Summary Annex form part of the Relevant Relationship and are valid as a matter of New York law, then the Position Liquidation Rights would be recognised and upheld by Australian Courts.

Close-out netting theory

Where the close-out netting theory applies, then, as considered in paragraph 2 of Part E, section 14(2)(c) of the Netting Act can apply to validate the exercise of the Close-out Netting Rights, such that, where a party goes into external administration governed by Australian Law:

- obligations under a close-out netting contract may be terminated;
- termination values may be calculated; and
- a net amount becomes payable,

in accordance with the close-out netting contract.

Section 14(2)(c) of the Netting Act applies subject to (i) any specified stay provision which is applicable to the Clearing Agreement and (ii) sections 14(4) and 14(5) of the Netting Act.

As considered in paragraph 2.1 of Part E, to the extent that the Close-out Netting Rights comprise the Position Liquidation Rights, then section 14(2)(c) can validate the exercise by the FCM of the Position Liquidation Rights on the basis and in the circumstances referred to in that paragraph.

Security Interest

Our comments immediately above assume that the FCM is not, in exercising its Position Liquidation Rights, enforcing the Security Interest granted by the Customer to the FCM as secured party in Covered Collateral. Please see Part G with respect to the exercise by the FCM of its rights as secured party in respect of the Security Interest in Covered Collateral granted by the Customer.

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0.3 ***Question 3: Would the FCM's holding of the Covered Contracts as an "agent-trustee" be recognized and upheld under the laws of your jurisdiction as creating a valid trust over the Covered Contracts or would the court otherwise recognize the FCM's legal title to, and the Covered Customer's beneficial interest in, the Covered Contracts?***

Where the trust theory applies then, subject to and as considered in paragraph 4 of Part B, in our view, the Relevant Relationship would be recognised under Australian Law as a trust for the purpose of determining the appropriate governing law of the Relevant Relationship and New York law would be recognised as the governing law of the Relevant Relationship. This recognition would include recognition of the validity, interpretation and effect of the proprietary rights of the Customer which are established by the Relevant Relationship under New York law, and Australian Law would recognise the Customer's interest in respect of the Customer Transactions as being a beneficial interest in the Customer Transactions held by the FCM on the terms of the Relevant Relationship.

We assume that, as a matter of New York law, a beneficiary's interest in respect of the Customer Transactions is a beneficial interest in the Customer Transactions held by the FCM on the terms of the Relevant Relationship and not in any specific Customer Transactions held by the FCM. On this basis, the nature of the interest of the Customer in the relevant Customer Transactions will be recognised under Australian Law accordingly, which would not treat the Covered Customer as having an ownership right in any specific Customer Transactions held by the FCM on the terms of the Relevant Relationship outright. Furthermore, Australian Law recognises that assets constituting trust property may change from time to time.

(a) ***If so, would the court characterize Position Liquidation as the FCM's exercising its contractual rights as principal vis-à-vis the DCO under the relevant DCO rules (or vis-à-vis the Foreign Futures Broker under the clearing agreement between the FCM and Foreign Futures Broker) and not as the FCM's acting as the Covered Customer's agent or as the FCM's enforcing its security interest in the Covered Contracts?***

We assume that, under all applicable laws (other than Australian law):

(i) the Position Liquidation Rights would be recognised and characterised as contractual rights of the FCM under the Base Account Agreement and the CDA to take certain

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actions as principal in accordance with the DCO rules (or vis-à-vis the Foreign Futures Broker, under the clearing agreement between the FCM and Foreign Futures Broker); and

(ii) the Covered Customer has no right or interest under the DCO rules (or vis-à-vis the Foreign Futures Broker, under the clearing agreement between the FCM and Foreign Futures Broker).

On this basis, and subject to and as discussed in Part B above and our comments below, Australian Law would recognise and characterise the Position Liquidation in the same manner.

In this respect, we note our understanding that:

(A) a Covered Customer is not a party to the Customer Transactions, which are entered into on a principal-to-principal basis between the FCM and the DCO or the Foreign Futures Broker. The FCM is fully liable as principal for all amounts owing to the DCO or Foreign Futures Broker in connection with the FCM's Customer Transactions;[77]

(B) this principal-to-principal relationship is governed by the terms of the DCO rules and procedures and membership agreement, or the clearing agreement between the FCM and the Foreign Futures Broker, to which the Covered Customer is in neither case a party;

(C) the Covered Customer is not in privity of contract with the DCO or Foreign Futures Broker with respect to the Customer Transactions, and neither the DCO nor the Foreign Futures Broker has any liability to the Covered Customer and the Covered Customer has no rights or claims against the DCO or Foreign Futures Broker. Rather, there is an overall duty on the FCM to account to the Covered Customer for the net amount due under the terms of the Relevant Relationship.

(b) ***Could the FCM's holding of the Covered Customer's Contracts be characterized as some alternative arrangement, such as a commission agency or as a collateral security***

[77] See the S&C Memorandum, Sections VI and VII.

arrangement? If so, how would the FCM's Position Liquidation be characterized under the laws of your jurisdiction?

Please see our analysis in Part G with respect to the creation, perfection and enforcement of the Security Interest granted by the Covered Customer to the FCM in Covered Collateral.

With respect to 'commission agency', we note that, as a matter of Australian law, there is presently no distinct concept of 'commission agency' which would be relevant in this context.

0.4 ***Question 4: Would a court in your jurisdiction recognize the statutory trust with respect to the Segregated Funds or Separate Account Funds of each Account Class as creating a valid trust over such Segregated Funds or Separate Account Funds, and that under the terms of that trust, the FCM holds the legal title to, and the Covered Customer holds a beneficial interest in, the statutory trust as a whole (as opposed to maintaining an interest in any specific assets under the trust)? Could the statutory trust with respect to the Segregated Funds or Separate Account Funds of any Account Class be characterized as some alternative arrangement (e.g., as a collateral security arrangement)?***

Where the trust theory applies then, subject to and as considered in paragraph 4 of Part B above, in our view, Australian Law would recognise each Statutory Trust as a trust for the purpose of determining the appropriate governing law of each Statutory Trust and U.S. Federal law would be recognised as the governing law of each Statutory Trust. This recognition would include recognition of the validity, interpretation and effect of proprietary rights of the FCM as trustee to administer or to dispose of the relevant Statutory Trust Property.

We assume that, as a matter of U.S. Federal law and in respect of a Statutory Trust, a Customer's interest in respect of the Statutory Trust Property is in the Statutory Trust Property as a whole (i.e. the Covered Customer's beneficial interest in the Statutory Trust Property is an interest in a proportionate share of each asset constituting the Statutory Trust Property) and not in any specific asset that may at a particular point in time constitute part of the Statutory Trust Property. On this basis, the nature of the interest of the Customer in the Statutory Trust Property as a whole will be recognised under Australian Law accordingly. Furthermore, Australian Law recognises that assets constituting trust property may change from time to time.

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Please see Part G with respect to the exercise by the FCM of its rights as secured party in respect of the Security Interest in Covered Collateral granted by the Customer.

(a) ***Would the Margin Liquidation provisions of each of the Base Account Agreement and CDA be enforceable under the laws of your jurisdiction and the FCM's Margin Liquidation in respect of each Account Class be recognized and upheld by a court in your jurisdiction? Could such Margin Liquidation be capable of exercise based on the FCM's exercise of its right under the applicable Customer Property Rules to withdraw and apply Segregated Funds or Separate Account Funds, as the case may be, for Permitted Uses (the FCM's "Permitted Uses Rights") rather than by the enforcement of its security interest in the Covered Customer's Collateral consisting of securities?***

Our response in paragraph 1.2 of this Part F applies equally to Margin Liquidation Rights and the Statutory Trusts (including where they rely on the exercise of Permitted Uses Rights) as it does to Position Liquidation Rights and the Relevant Relationship, noting our additional comments below.

As noted above, please see Part G with respect to the exercise by the FCM of its rights as secured party in respect of the Security Interest in Covered Collateral granted by the Customer.

Trust theory

With respect to the Permitted Uses Rights, as noted in paragraph 3(iii) of Part D, we understand that under applicable U.S. law the Permitted Uses are an inherent element of each Statutory Trust.

(b) ***Would the Determination of Account provisions of each of the Base Account Agreement and CDA be enforceable under the laws of your jurisdiction and the FCM's Determination of Account in respect of (i) each Account Class and (ii) all Account Classes on a combined basis be recognized and upheld by a court in your jurisdiction and if so, how could each Determination of Account be characterized (e.g., contractual accounting, netting or set-off, enforcement of the security interest in cash Collateral or some combination of the foregoing)?***

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Security Interest

Please see Part G with respect to the exercise by the FCM of its rights as secured party in respect of the Security Interest in Covered Collateral granted by the Customer.

Trust theory

Where the trust theory applies and as noted in Part B above, we understand and assume that, as a matter of all applicable laws (other than Australian Law):

(i) the calculation by the FCM of the Determination of Account in respect of an Account Class is merely a computation of a net amount in accordance with the Covered Agreement;

(ii) the exercise by the FCM of the Determination of Account Rights:

() is not intended to impact, affect, or extinguish the underlying legal obligations or create new legal relationships between the FCM and the Covered Customer;

() is not inconsistent with any interest of the Covered Customer in, or right of the Covered Customer in respect of, the Customer Transactions, or Segregated Funds or Separate Account Funds, (as relevant) which are held on the terms of the Relevant Relationship or the relevant Statutory Trust (respectively);

(A) does not involve any denial of obligations or acceleration of debt under the Covered Agreement, any close out of transaction relating to the Covered Agreement or any enforcement of security under the Covered Agreement, nor any set-off; and

(iii) where the Customer's Account comprises multiple Account Classes, the right of the FCM to determine a single aggregate balance in respect of all Account Classes forms part of and is an inherent element of the Relevant Relationship and each Statutory Trust, and the Customer only ever has an entitlement to that single aggregate balance in respect of the Relevant Relationship and each Statutory Trust.

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On this basis, assuming that the Determination of Account Rights are valid as a matter of New York law and U.S. Federal law, then the Determination of Account Rights would be recognised and upheld by Australian Courts.

(i)an approved ***Close-out netting*** arrangement;***theory***

Please see our response in paragraph 1.2 of this Part F with respect to section 14(2)(c) of the Netting Act.

As considered in paragraph 2.1 of Part E, to the extent that the Close-out Netting Rights comprise the Determination of Account Rights, then section 14(2)(c) can validate the exercise by the FCM of the Determination of Account Rights, pursuant to which:

(I) where the Customer's Account comprises one Account Class, a single Determination of Account becomes payable between the parties in respect of that Account Class, or

(II) where the Customer's Account comprises multiple Account Classes, a single aggregate balance becomes payable between the parties in respect of all the Account Classes.

0.5 ***Question 5: Are there any other circumstances in your jurisdiction, including any moratorium, stay, freeze or other consequence of the commencement of an insolvency proceeding, you can foresee that might affect the FCM's ability to exercise Position Liquidation, Margin Liquidation or a Determination of Account in respect of an Account Class or the overall Customer Account (comprising the three Account Classes)?***

Trust theory

Please see our discussion in Part D, including in relation to the General Insolvency Principles, Statutory Avoidance Provisions, Specified Stay Provisions and other stays and moratoria.

Close-out netting theory

(ii)a Where the close-out netting contract;theory applies, and a party goes into external administration governed by Australian law, section 14(2)(c) of the Netting Act applies subject to:

(a) any specified stay provision which is applicable to the Clearing Agreement (in respect of which, please see paragraph 3 of Part E); and

(b) sections 14(4) and 14(5) of the Netting Act (in respect of which, please see paragraphs 5.1 and 5.2 of Schedule 1).

0.6 ***Question 6: Under the laws of your jurisdiction, are any rights or processes available to a creditor of a Covered Customer by which such creditor could make a claim against the Segregated Funds or Separate Account Funds held subject to the statutory trust (or otherwise in accordance with the Customer Property Rules) in respect of each Account Class or against the Covered Contracts (and any rights in respect thereof) held by the FCM as agent-trustee for the benefit of the Covered Customer and the FCM's other customers in such Account Class as opposed to only having recourse to the final cash balance or single net termination amount that constitutes the Determination of Account for such Account Class or the overall Customer Account (comprising the three Account Classes)?***

On the basis considered in paragraph 1.4 of this Part F, where the trust theory applies, Australian Law would recognise a Customer's interest in respect of the Statutory Trust Property as being in the Statutory Trust Property as a whole and not in any specific Customer Funds that may at a particular point in time constitute part of the Statutory Trust Property. As a result, a creditor of a Covered Customer will only be entitled to claim against the single net amount that constitutes the Determination of Account, if this is payable by the FCM to the Customer, and not any specific Customer Funds.

0.7 ***Question 7: Assuming the parties have entered into a Covered Agreement, the Covered Customer is insolvent and the FCM has determined a lump-sum cash balance or net termination amount in a currency other than the currency of the jurisdiction in which the insolvent customer is organized:***

(a) Would a court in your jurisdiction enforce a claim for the cash balance or net termination amount in the currency in which it was determined?

(b) Can a claim for the net termination amount be proved in insolvency proceedings in your jurisdiction without conversion into the local currency?

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If in either case the claim must be converted to local currency for purposes of enforcement or proof in insolvency proceedings, please set out the rules governing the timing and exchange rate for such conversion.

Trust theory

Please see our discussion on this point where the trust theory applies in paragraph 6 of Part D.

Close-out netting theory

Please see our discussion on this point where the close-out netting theory applies in paragraph 4 of Part E.

0.8 ***Question 8: Are there any other local law considerations that you would recommend the FCM to consider in connection with the exercise of the Position Liquidation, Margin Liquidation or a Determination of Account?***

No.

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Part G Responses to questions on Creation, Perfection and Enforcement of FCM's Security Interest in Covered Collateral

In this Part G we address the questions contained in your Instructions in relation to the creation, perfection and enforcement of FCM's Security Interest in Covered Collateral. Each question is set out in italics followed by our response. We do not express any opinion with respect to any security other than the Security Interest.

You have instructed us that the Security Interest granted by the Covered Customer to the FCM is in the collateral consisting of (1) the Customer Account, (2) the Covered Customer's Covered Contracts, (3) cash credited to an account (as opposed to physical notes and coins) and (4) the types of securities that are identified in additional assumption in II.B.(c) of the Instructions in Annex 2 of this opinion and that are Located or deemed Located either (i) in the Australian Jurisdictions or (ii) outside of the Australian Jurisdictions.[78] Accordingly, in this Part G, we consider the Security Interest in the Customer Account, the cash, securities and other property which comprise the Customer Funds, and the Customer Transactions, that are recorded in the Customer Account, and rights associated with such collateral.

For the purposes of this opinion, there are two key pieces of legislation relevant to the Security Interest, being the PPSA, aspects of which are summarised in Schedule 2, and the Netting Act, aspects of which are summarised in Schedule 3. Our responses to the questions in this Part G refer to these Schedules and are intended to be read in conjunction with those Schedules. Where our responses to the questions differ depending on whether the trust theory or the close-out netting theory applies, we have indicated this within the response.

Before responding to the questions, we provide some background relevant to our responses.

[78] See additional assumption in II.B.(a) of the Instructions in Annex 2 of this opinion. See also paragraphs 1.36 to 1.41 and footnote 36 of the Summary Annex, and Section X of the S&C Memorandum.

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0 Creation and perfection of the Security Interest

0.1 Security interest under the Covered Agreement

(a) Application of the Netting Act

As noted in paragraph 2 of Part D above, the Netting Act contains provisions which protect the enforcement of security in respect of particular obligations under 'close-out netting contracts'.

Trust theory

As considered in paragraph 2 of Part D above, in our view, where the trust theory applies, the Covered Agreement should not be regarded as a close-out netting contract. Accordingly, where the trust theory applies, the protection granted by the Netting Act to the enforcement of security in respect of amounts owing under such contracts would not apply.

To the extent that our following analysis in this Part G relates to the Netting Act, that analysis is not relevant where the trust theory applies and is only relevant where the close-out netting theory applies.

Close-out netting theory

Where the close-out netting theory applies, then, on the basis considered in paragraph 2 of Part E, the Clearing Agreement should be a close-out netting contract for the purpose of the Netting Act. Accordingly, we consider below the protection of the enforcement of security in respect of obligations of a party to a close-out netting contract provided by section 14(2) of the Netting Act where the close-out netting theory applies.

(b) Jurisdictional reach of PPSA and nature of the Security Interest

As considered in Schedule 2, the PPSA contains jurisdictional provisions which define the application of the PPSA to a security interest by reference to a connection with Australia. Relevantly, it provides that the PPSA applies to a security interest in any class of personal property if the grantor of the security interest is an Australian entity, which includes an "Australian Company" (as defined in paragraph 4 of Part A above).

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The Security Interest is granted in the form of a New York law security interest in favour of the FCM by the Customer. It is therefore necessary to consider whether the Security Interest is effective, as a matter of New York law, to create rights for the FCM which Australian Law would recognise as being in the form of a security interest.

Under the PPSA, as discussed in Schedule 2, a security interest is defined as an "interest in personal property provided for by a transaction that, in substance, secures payment or performance of an obligation". We understand and have assumed that, as a matter of New York law, the Clearing Agreement is effective to create a security interest of this nature in favour of the FCM.

(c) **PPSA collateral class**

The laws governing the validity of, and steps for attachment and perfection of, a security interest in personal property under the PPSA depend on the PPSA collateral class attributed to the personal property for the purposes of the PPSA.

Based on the other assumptions which we have been asked to make for the purposes of this opinion and our comments in this Part G above, the Customer Account, Customer Funds and the Customer Transactions that are recorded in the Customer Account and subject to the Security Interest should fall within the PPSA collateral classes 'intermediated security', for the reasons considered below. The PPSA collateral class of rights associated with such collateral should be 'proceeds'.[79]

The PPSA defines an 'intermediated security' as the rights of a person in whose name an intermediary maintains a 'securities account'. A 'securities account' is defined as, relevantly, an account to which interests in financial products may be credited or debited. In this context, financial products are, relevantly, bonds, any other financial instrument and any other financial asset (other than cash), or any interest in any of them. In accordance with your instructions, we

[79] This opinion does not consider any other PPSA collateral classes.

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assume in this opinion that the Customer Account is a 'securities account' for the purposes of the PPSA.

Relevantly, an 'intermediary' is defined as a person who holds an Australian financial services licence ("**AFSL**") or licence under the law of a foreign jurisdiction permitting them to maintain securities accounts on behalf of others, but does not include a central bank. In accordance with your instructions, we assume in this opinion that the FCM either holds an AFSL or a licence under the law of a foreign jurisdiction permitting them to maintain securities accounts on behalf of others or on behalf of others as well as on its own behalf, and is not central bank, and is therefore an 'intermediary' for the purposes of the PPSA.

On this basis, in our view, the PPS collateral class in respect of the Customer Account, Customer Funds and the Customer Transactions that are recorded in the Customer Account should be 'intermediated securities' for the purposes of the PPSA, irrespective of whether the trust theory or the close-out netting theory applies. The reasons for this include that definition of 'intermediated securities' in the PPSA is defined as the rights of a person in whose name an intermediary maintains a 'securities account', irrespective of the nature of such rights. Accordingly, the mere fact that the Customer's interests in, and the contractual rights and obligations in respect of, the Customer Account, Customer Funds and the Customer Transactions that are recorded in the Customer Account may be characterised differently under the trust theory and the close-out netting theory as a matter of Australian Law and other applicable laws does not affect the PPS collateral class of the Covered Collateral being intermediated securities.

0.2 Law governing contractual aspects of security interest

Question 1: Under the laws of your jurisdiction, what law governs the contractual aspects of the security interest in the various forms of Covered Collateral?

Under general Australian Law, the law governing the contractual aspects of the Security Interest granted by an Australian Company in the collateral identified is the governing law of the Clearing Agreement, being New York law. The 'governing law' provisions of the PPSA (described in the

paragraph immediately below) expressly state that those provisions do not affect the law that governs contractual obligations (including any obligations arising under a security agreement).

Additional comments where close-out netting theory applies

The Netting Act does not contain rules to determine the law governing the contractual of security interests and, consequently, we do not consider that there is any inconsistency between the Netting Act and the application of the PPSA in this regard. Accordingly, our answer to this question applies in the same way, irrespective of whether the Netting Act applies to protect the enforcement of a security.

0.3 Law governing validity and perfection of security interest

Question 2: Under the laws of your jurisdiction, what law governs the proprietary aspects of the security interest in the different types of Covered Collateral (that is, the formalities required to protect the security interest against competing claims) granted by the Covered Customer (for example, the law of the jurisdiction of incorporation or organization of the Covered Customer, the jurisdiction where the Covered Collateral is Located or the jurisdiction of location of the FCM as the Covered Customer's Intermediary, in relation to Covered Collateral in the form of indirectly held securities)? What factors would be relevant to this question? If the Location (or deemed Location) of the Covered Collateral is the determining factor, please briefly describe the principles governing such determination under the law of your jurisdiction with respect to the different types of Covered Collateral. If relevant, please describe how the laws of your jurisdiction apply to each form in which securities Covered Collateral may be held as described in assumption (b) above.

(a) The laws governing the validity of the Security Interest

In addition to the provisions which define the jurisdictional reach (described in paragraph 1.1(b) above), the PPSA contains provisions which set out which law, in proceedings in an Australian

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Court, governs the validity of security interests to which the PPSA applies.[80, 81] However, those PPSA provisions do not set out the governing law applicable to the validity of a security interest in intermediated securities where the security agreement is not governed by Australian law.[82] In our opinion, the better view is that the general Australian Law should determine the law governing the validity of a security interest.[83]

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80 These 'governing law' provisions apply only to interests that arise on or after 30 January 2012, being the date on which the PPSA commenced operation.

81 There are limited separate provisions dealing with the jurisdictional linkage required for the operation of the enforcement provisions in the PPSA and for priorities of security interests in property which has been relocated to Australia. We do not comment on those in this opinion.

82 No explanation for this is given in the Explanatory Memorandum to the Personal Property Securities Bill 2009 (Cth) ("**PPS Bill**"). Initial drafts of the PPS Bill did include provisions applicable to intermediated securities which were based on The Hague Conference Convention of 5 July 2006 on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary, which Australia has not signed.

83 The PPSA expressly does not repeal the common law, including in relation to choice of law rules, to the extent that it is capable of operating concurrently with the PPSA. This interpretation is consistent with the statement in Paragraph 7.2 of the Explanatory Memorandum for the PPS Bill that:

> "As there are connecting factors which must be met before Australian law is able to determine which law governs a security agreement, Part 7.2 should be read together with clause 6, Connection with Australia."

The alternative view would be that the absence of governing law rules in Part 7.2 of the PPSA in relation to a security interest in intermediated securities was intended to result in the validity and perfection requirements in the PPSA applying to all intermediated securities to which the PPSA applies – being those granted by an Australian entity or where the intermediary is located in Australia. However, there is no indication that the omission of an express reference to intermediated securities from the governing law rules in the PPSA was intended to produce this result. Taking into account that such a result would have been a significant departure from previously applicable general law principles, and is not mentioned in the explanatory memorandum which accompanied the PPSA, this intention seems unlikely. Also, if this were intended, then it would have been easily achieved by the inclusion of intermediated securities in the rules applying to financial property, such as investment instruments. These rules focus on the location of grantors (which is different to whether they are Australian entities as it excludes foreign incorporated companies), the time of attachment and perfection and potentially the location of the property at those times. The implication that the absence of any reference to intermediated securities in Part 7.2 was intended to result in a much less sophisticated rule applying to intermediated securities (which makes no reference to whether the grantor is "located" in Australia) is somewhat difficult to support. Instead, we consider that the intention was for the PPSA to not affect the general law rules on location of property which previously applied to intermediated securities. This is consistent with the absence of any reference to intermediated securities in Part 7.2. Also, it makes sense from a policy perspective if the new rules on intermediated securities evidenced in earlier PPSA drafts were not able to be included until Australia signed the Hague Convention on intermediated securities.

Under general Australian Law, assuming that the choice of law in the Clearing Agreement is a valid and proper choice of law (in respect of which, please see our comments in paragraph 3.1 of Part B above), the Australian Courts should recognise the validity of the Security Interest assuming that the security interest was valid under the governing law of the Clearing Agreement, being New York law.

In addition to the rules above, the 'governing law' provisions of the PPSA provide that the laws of the jurisdiction which govern the validity of the security interest in collateral also apply to the validity of the security interest in proceeds of that collateral.[84]

Additional comments where the close-out netting theory applies

The Netting Act does not contain rules to determine the law governing the validity of security interests. Accordingly, our answer to this question applies in the same way, irrespective of whether the Netting Act applies to protect the enforcement of a security.

(b) **The laws governing the perfection of the Security Interest**

The PPSA provisions referred to in paragraph (a) above do not set out the governing law applicable to the perfection and effect of perfection or non-perfection of a security interest in intermediated securities where the security agreement is not governed by Australian law.

Under the general Australian Law (particularly rules of private international law and conflicts of laws), the better view is that the relevant law governing the perfection and effect of perfection or non-perfection of a security interest in a chose in action is the law of the place of its location (lex situs). Although Australian Law is not entirely clear on this issue, the most likely outcome is that the governing law is the law of the place where the intermediary is located (referred to as the *place of the relevant intermediary approach* ("**PRIMA**")).[85]

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[84] Unless the proceeds are an account (unless the account arises from the dealing which gave rise to the proceeds).

[85] The Hague Conference Convention of 5 July 2006 on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary, which, as noted above, Australia has not signed, recognised PRIMA.

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We are not aware of any Australian authority directly on this point in this context, and we note that commentators have indicated that there is significant difficulty in determining the "place" of an intermediary. However, we expect that an Australian Court would consider the following factors in determining the place of the intermediary:

(i) the law chosen by the parties to govern the Customer Account;

(ii) the place of administration of the Customer Account; and

(iii) the place of residence or business of the intermediary.

We assume that the place where the intermediary is located for these purposes is not Australia. On this basis, the law governing the perfection and the effect of perfection or non-perfection in the relevant Security Interest in the intermediated securities should not be Australian law.

In addition to the rules above, the laws of the jurisdiction which govern the perfection and the effect of perfection or non-perfection of a security interest in collateral also apply to the perfection and effect of perfection or non-perfection of that security interest in the proceeds of that collateral (respectively).

Additional comments where close-out netting theory applies

The Netting Act does not contain rules to determine the law governing the perfection and effect of perfection or non-perfection of security interests and, consequently, we do not consider there is any inconsistency between that Act and the application of the PPSA in this regard. Accordingly, our answer above applies equally irrespective of whether the Netting Act applies to protect the enforcement of a security. However, see our comments in respect of the relevance of perfection to the extent that the Netting Act applies to the enforcement of security in paragraph 1.4(d) below.

0.4 Recognition of security interest

Question 3: Would the courts of your jurisdiction recognize the validity of a security interest in the different types of Covered Collateral, assuming it is valid under New York law? In answering this question, please bear in mind the different forms in which securities Covered Collateral may be held, as described in the assumptions above. Please indicate, in relation to

cash Covered Collateral, if your answer depends on the location of the account in which the relevant deposit obligations are recorded and/or upon the currency of those obligations.

(a) **Recognition of the Security Interest**

In our opinion, Australian Courts would recognise a security interest in intermediated securities created under the Clearing Agreement, provided that:

(i) the security interest was valid under the laws that govern the validity of the security interest (as to which see paragraph 1.3(a) above); and

(ii) any perfection requirements in relation to the collateral had been complied with under the laws that govern the perfection and effect of perfection or non-perfection of the security interest (as to which see paragraph 1.3(b) above).

We have assumed that the Customer Funds, including any cash, are recorded in the Customer Account, and refer to our comments in the paragraph immediately above regarding the location of the securities account and the FCM for these purposes. Our response to this question 3 is not dependent upon the currency of those obligations.

(b) **PPSA provides for enforceability against grantor and third parties**

If Australian Law governs the validity of the security interest (which is the case, as set out in paragraph 1.3(a) above), then the PPSA provides that the security interest in collateral:

(i) is enforceable against a grantor only if the security interest has attached to the collateral; and

(ii) is enforceable against a third party only if:

() the security interest is attached to the collateral; and

(A) one of the following applies:

(aa) the secured party possesses the collateral;

(ab) the secured party has perfected the security interest by control; or

(ac) a written security agreement that provides for the security interest covers the collateral.

The PPSA requirement of attachment is considered below.

On the basis of our understanding that the Security Interest is granted under the terms of the Customer Agreement, the requirement for a written security agreement should be satisfied by the Clearing Agreement.[86]

(c) **PPSA requirement of attachment**

Once a security interest is attached to personal property, it is referred to as "**collateral**" under the PPSA. A security interest attaches to collateral under the PPSA when:

(i) the grantor has rights in the collateral, or the power to transfer rights in the collateral to the secured party; and

(ii) either:

(A) value is given for the security interest; or

(B) the grantor does an act by which the security interest arises.

Under the Clearing Agreement, value, in most cases, should be seen as given because of the continuing reciprocal obligations of the parties under the Clearing Agreement and the entering into of new Transactions pursuant to, and subject to, the terms of the Clearing Agreement.

If collateral gives rise to proceeds, the security interest attaches to the proceeds unless the security agreement provides otherwise.

[86] Provided that the Clearing Agreement is signed by the Covered Customer or otherwise adopted or accepted by it by an act or omission that reasonably appears to be done with the intention of adopting or accepting the writing.

Close-out netting theory

Where the close-out netting theory applies, we note the following.

(d) **Possession and control requirements under the Netting Act**

As noted above, for the Netting Act protection to apply to the enforcement of security, a number of conditions need to be met, including that the collateral must be, before enforcement, transferred or otherwise dealt with so as to be in the possession or under the control of the FCM, or another person (who is not the Customer) on behalf of the FCM under the terms of an arrangement evidenced in writing. Whilst some aspects of the possession and control concepts are questions of law, it is also a question of fact as to whether Collateral has been transferred or otherwise dealt with so as to be in the possession or under the control of the FCM or another person (who is not the Customer) on behalf of the FCM, under the terms of an arrangement evidenced in writing. To that end, there are specific circumstances in which possession and control will, and will *not*, exist for the purposes of the Netting Act as set out below (although these are not intended to be an exhaustive list). Please see Schedule 3 with respect to some of these circumstances.

0.5 Effect of fluctuating exposures or Collateral

Question 4: What is the effect, if any, under the laws of your jurisdiction of the fact that the amount secured or the amount of any cash or securities Covered Collateral subject to the security interest will fluctuate under the Covered Agreement (including as a result of entering into additional Covered Transactions from time to time)? In particular:

(a) Would the security interest be valid in relation to future obligations of the Covered Customer?

(b) Would the security interest be valid in relation to future Covered Collateral (that is, Covered Collateral not yet delivered to the FCM at the time of entry into the Covered Agreement)?

(c) Is there any difficulty with the concept of creating the security interest over a fluctuating pool of assets, for example, by reason of the impossibility of identifying in

the Covered Agreement the specific assets deposited by the Covered Customer with the FCM?

(d) Is it necessary under the laws of your jurisdiction for the amount secured by the security interest to be a fixed amount or subject to a fixed maximum amount?

(e) Is it permissible under the laws of your jurisdiction for the FCM to hold Customer Collateral in excess of its actual exposure to the Covered Customer under the Covered Agreement?

In relation to (a), it is understood that the security interest in any specific Covered Collateral would only be relevant in relation to future obligations, if ever, at the time such future obligations arise and then only in relation to Covered Collateral held at that time. This question concerns whether it would be necessary for either party to perform any action at such time in order to ensure the effectiveness of the security interest as security for such obligations or whether the security interest would take effect in relation to those future obligations without further action by either party.

In relation to (b), it is understood that the security interest in the different types of Covered Collateral to be delivered at some point in the future after the time of entry into the Covered Agreement would not take effect in relation to such Covered Collateral until it had been delivered to the FCM in accordance with the Covered Agreement. This question concerns whether it would be necessary for either party to perform any action at such time in order to ensure the effectiveness of the security interest in relation to such Covered Collateral or whether the security interest in relation to such Covered Collateral would take effect without further action (other than the delivery) by either party.

In relation to (c), you may assume that each specific delivery to the FCM and return by the FCM of Covered Collateral consisting of cash or securities under the Covered Agreement from time to time would be properly recorded by the FCM, so that, while the pool of Collateral would change from time to time, at any specific time the composition of the pool of Collateral could be clearly identified by the FCM.

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As a matter of Australian Law there are no adverse consequences arising from the fact that the amount secured or the amount of Covered Collateral transferred from time to time will fluctuate under the Covered Agreement, provided it does so in accordance with the terms agreed between the parties.

Subject to the proviso above, and in answer to the specific questions on this point:

(a) Future obligations

The security interest would be valid in relation to future obligations of the Covered Customer, provided the future obligations are able to be identified as and when they arise, by reference to the terms of the Covered Agreement. The PPSA provides that a security agreement may provide for future advances, and that a security interest provided for by a security agreement has the same priority in respect of all advances (including future advances) and obligations secured by the agreement.[87,88]

(b) Future collateral and (c) fluctuating pool of assets

As a general matter, the security interest would be valid in relation to future collateral, provided the future collateral is able to be ascertained as and when it is provided as collateral. The PPSA provides that a security agreement may provide for security interests in after-acquired property and that a security interest in after-acquired property attaches without specific appropriation by the grantor.

There is no difficulty with the concept of creating a security interest over a fluctuating pool of assets, provided the pool of assets is identified with sufficient clarity to identify the collateral at any given time.

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[87] An "*advance*" is broadly defined to mean the payment of currency, the provision of credit or the giving of value and includes any liability of a debtor to pay interest, credit costs and other charges or costs payable by the debtor in connection with the advance or the enforcement of a security interest securing the advance. A "*future advance*" is defined broadly to mean an advance secured by a security interest (whether or not made pursuant to an obligation), if the advance is made after the security agreement was made or expenses in relation to the enforcement of a security interest that are secured by the security interest.

[88] Our conclusion is not altered by the fact that specific Transactions to which the Covered Collateral relates will change over time as the counterparties enter into new Transactions under a particular Covered Agreement and as Transactions terminate according to their terms.

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Additional comments where close-out netting theory applies

In regard to the effect of the Netting Act protection of the enforcement of security on the above, the related Explanatory Memorandum provides as follows:

> "The protections provided under this Bill provide a facilitative protective regime (subject to the safeguards set out in the Bill) and do not adversely affect existing Australian laws. For example, it is noted that under existing Australian law, security may be valid notwithstanding the fact that the security secures future obligations or fluctuating obligations, or that the security is granted over a fluctuating but identified and identifiable pool of property (provided it does so in accordance with the terms agreed between the parties), or that the grantor may provide financial property in excess of the secured obligations. Additionally, the Bill does not impose a requirement for the amount secured to be subject to a fixed amount or fixed maximum amount which does not otherwise exist under Australian law".[89]

(c) Necessity for fixed amount

It is not necessary under Australian Law for the amount secured by a Covered Agreement to be a fixed amount or subject to a fixed maximum amount.

(d) Excess Customer Collateral

It is permissible under Australian Law for the FCM to hold Customer Collateral in excess of its actual exposure to the Covered Customer under the Covered Agreement.

0.6 Steps for perfection

Question 5: Assuming that the courts of your jurisdiction would recognize the security interest in each type of Covered Collateral, is any action (filing, registration, notification, stamping, notarization or any other action or the obtaining of any governmental, judicial, regulatory or other order, consent or approval) required in your jurisdiction to perfect the security interest?

[89] 2016 Explanatory Memorandum, [1.105].

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If so, please indicate what actions must be taken and how such actions may differ, if at all, depending upon the type of Covered Collateral which is subject to the security interest.

On the basis considered in paragraph 1.3(b) above, Australian law will not govern the perfection of the Security Interest in an intermediated security.

However, notwithstanding that Australian law will not govern perfection of the Security Interest in intermediated securities, the effect of one of the PPSA rules is that, if the laws of the jurisdiction that govern the perfection of the Security Interest in intermediated securities do not provide for the public registration or recording of the Security Interest or a notice relating to the Security Interest, then the Security Interest will have priority, in proceedings in an Australian Court, over another interest in the intermediated securities if:

(a) the Security Interest is perfected by registration under the PPSA before the other interest attaches to the intermediated securities; and

(b) when the other interest arises in the intermediated securities, the intermediated securities are located in Australia and the secured party does not have control of them.

Generally, this rule sets out circumstances where perfection by registration in Australia will provide a priority benefit even though perfection issues in relation to the security interest are governed by a foreign law.[90] It operates as an exception to the general rules about governing law in relation to perfection issues (which we discuss in paragraph 1.3(b)). However, we are not aware of any authoritative case law which specifically considers the application of this rule of the PPSA in this context.

As a consequence of this rule, if the laws of the jurisdiction that govern the perfection of the Security Interest do not provide for the public registration or recording of the Security Interest or a notice relating to the Security Interest and the Security Interest in intermediated securities is perfected by registration under the PPSA before another interest attaches to the intermediated securities, then the

[90] S Pemberton, "Priority, extinguishment and enforcement issues: Importing, exporting and transnational property" (January 2016) in Wappett, Whittaker and Edwards *Personal property securities in Australia*, [4.12.2900].

Security Interest will take priority over that other security interest in proceedings in an Australian Court if, when the other interest arises in the intermediated securities, the intermediated securities are located in Australia and the secured party does not have control of the intermediated securities.

With respect to paragraph (b) above and the reference to the personal property being located in Australia, the PPSA provides that personal property is located in the particular jurisdiction in which the personal property is situated. However, the PPSA does not contain any specific rules regarding the situation of intermediated securities, and we are not aware of any judicial consideration of this in the context of the PPSA for these purposes. In any case, if, when the other interest arises in the intermediated securities, the intermediated securities are not located in Australia, then this priority rule should not apply.

Similarly, if the secured party has control of the intermediated securities for the purposes of the PPSA (in relation to which the law is unclear as to how control is interpreted with respect to this priority rule and which is beyond the scope of this opinion), this priority rule should not apply. Generally, we note that it is technically possible for a secured party in respect of another security interest in the intermediated securities to also have control.

Additional comments where close-out netting theory applies

In order for the Netting Act protection to apply to the enforcement of the security, a number of conditions need to be met, including that the Covered Collateral must be transferred or otherwise dealt with before enforcement so as to be in the possession or under the control of the FCM, or another person (who is not the Customer) on behalf of the FCM. Please see paragraph 2.5 of Schedule 3 with respect to possession and control under the Netting Act.

0.7 Other requirements for valid security interests

Question 6: If there are any other requirements to ensure the validity or perfection of the security interest in each type of Covered Collateral, please indicate the nature of such requirements. Are there any other documentary formalities that must be observed in order for the security interest in any type of Covered Collateral to be recognized as valid and perfected in your jurisdiction?

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Irrespective of whether or not the Netting Act applies, there are no particular additional requirements or formalities to ensure the validity or perfection of security interests in relation to the contemplated collateral, other than any contemplated by the Clearing Agreement. It is not necessary as a matter of formal validity that the Clearing Agreement be expressed to be governed by Australian Law or that it be translated into another language or for them to include specific wording.

0.8 Action required to maintain security interest

Question 7: Assuming that the FCM has obtained a valid and perfected security interest under the laws of your jurisdiction, to the extent such laws apply, by complying with the requirements set forth in your responses to questions 1 to 6 in this Part G above, as applicable, will the FCM or the Covered Customer need to take any action thereafter to ensure that the security interest continues to be and/or remains perfected, particularly with respect to additional cash or securities Covered Collateral transferred from time to time when required pursuant to the Covered Agreement?

Once any additional Covered Collateral is transferred to the FCM and is subject to the security interest in favour of the FCM in accordance with the Covered Agreement, the validity, continuity, perfection or priority will be determined in the manner considered above. No additional actions of this kind will be required, provided any additional Covered Collateral is within the scope of the Covered Agreement.

0.9 FCM duties

Question 8: Are there any particular duties, obligations or limitations imposed on the FCM in relation to the care of the Covered Collateral held by it pursuant to the security interest?

The PPSA does not impose any duties on the FCM in relation to the care of collateral except in the exercise of enforcement rights provided for by the PPSA (in respect of which, please see paragraph 2.1 below).

0.10 Dealings with Collateral

Question 9: Do the laws of your jurisdiction recognize the right of the FCM to use cash or securities Covered Collateral (as described in additional assumption II.B.(f) above) pursuant to an agreement with the Covered Customer? In particular, how does such use of the Covered

Collateral affect, if at all, the validity, continuity, perfection or priority of the security interest otherwise validly created and perfected prior to such use? Are there any other obligations, duties or limitations imposed on the FCM with respect to its use of such Covered Collateral under the laws of your jurisdiction?

On the basis considered in paragraphs 1.3(a) and 1.3(b) above, Australian law will not govern the validity, perfection or effect of non-perfection of the Security Interest in an intermediated security. In light of this, in our view, there is no reason in principle why an Australian Court would seek to interfere with such arrangements if they were valid as a matter of New York law, being the governing law of the Clearing Agreement.

1 Enforcement of the Security interest in Covered Collateral in the absence of an insolvency proceeding

Note that the assumption in II.B.(d) of Annex 2 to this opinion applies to questions 10 to 12 below.

1.1 Formalities in exercising enforcement rights

Question 10: Assuming that the FCM has obtained a valid and perfected security interest under the laws of your jurisdiction, to the extent such laws apply, by complying with the requirements set forth in your responses to questions 1 to 6 above, as applicable, what are the formalities (including the necessity to obtain a court order or conduct an auction), notification requirements (to the Covered Customer or any other person) or other procedures, if any, that the FCM must observe or undertake in enforcing its security interest as an FCM under the Covered Agreement? For example, is it free to sell the Covered Collateral (including to itself) and apply the proceeds to satisfy the Covered Customer's outstanding obligations under the Covered Agreement? Do such formalities or procedures differ depending on the type of Covered Collateral involved?

The specific PPSA 'governing law' provisions with respect to the validity and perfection of a security interest do not extend to enforcement issues.[91] In our opinion the better view is that, in the absence of any other legislation determining the law governing the enforcement of a security interest, the general Australian Law will determine the governing law.

If Australian Law governs the enforcement of a security interest and the PPSA applies, then the PPSA sets out a series of rules on the enforcement of security interests in personal property. These rules regulate how a secured party seizes, disposes of and retains collateral and procedural requirements and duties that the secured party may need to comply with if it exercises those rights under the PPSA. Some, but not all of these, can be contracted out of.[92] However, the rights, powers and remedies of a secured party under the enforcement provisions in the PPSA are in addition to, and do not replace, those under the relevant Clearing Agreement and the general law. In our view, if a secured party exercises enforcement rights under a Clearing Agreement that are identical to the rights it is entitled to exercise under the PPSA and which the parties have not contracted out of, there is only a low risk that the secured party would have to comply with the PPSA procedural requirements and duties.[93] Also, with limited exceptions the enforcement provisions do not apply to a security interest over an investment instrument or intermediated security which is perfected by possession or control and do not apply to security granted by an Australian Company which is subject to a receiver or receiver and manager. The most significant of the enforcement provisions is that which requires that personal property or proceeds of collateral received by or on behalf of a secured party as a result of enforcing a

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[91] As noted in paragraph 1.3 above, the PPSA contains provisions which set out which law, in proceedings in an Australian Court, governs the validity, perfection and effect of perfection or non-perfection of security interests to which the PPSA applies.

[92] Those which cannot be contracted out of include that rights, duties and obligations must be exercised honestly and in a commercially reasonable manner, the duty to exercise all reasonable care to obtain at least the market value for collateral and the order of application of money received on enforcement.

[93] The reasons for this include that, traditionally, in the context of considering the enforcement of securities, enforcement under a security agreement has been distinguished from enforcement under rights conferred by the *Conveyancing Act 1919* (NSW) (and its equivalent in other jurisdictions). By parity of reasoning, a similar conclusion should be reached in the context of the PPSA enforcement provisions. Also, there is no provision in the PPSA deeming that if a secured party exercises rights that are available under both the enforcement provision and the general law or contract it is deemed to be exercising the former.

security interest in collateral must be applied in the following order whether the security interest was enforced under the PPSA or otherwise:

- higher ranking interests (other than security interests);
- reasonable enforcement expenses;
- higher ranking security interests;
- secured party;
- lower ranking security interests; then
- grantor.

The PPSA procedural requirements and duties that apply in respect of the enforcement of a security interest are not considered further in this opinion.

Under the general Australian Law, it is not necessary for any particular formalities to be followed in order to exercise the rights contemplated by a Clearing Agreement. In particular, a court order or auction is not required and notice of sale need not be given to the Covered Customer, although in practice secured creditors do often give a short period of notice before selling collateral. This does not differ depending on the type of collateral involved.

We have not considered further in this opinion the duties which are suggested by Australian cases, or statutory requirements, in relation to the exercise of any power of sale or appropriating collateral.

1.2 Special limitations on enforcement

Question 11: Are there any laws or regulations in your jurisdiction that would limit or distinguish a creditor's enforcement rights with respect to the security interest in any type of Covered Collateral depending on (a) the type of transaction underlying the creditor's exposure, (b) the type of Collateral or (c) the nature of the creditor or the debtor? For example, are there any types of "statutory liens" that would be deemed to take precedence over a security interest?

In relation to entities of the kind covered by this opinion, there are no rules or regulations of the kind mentioned in paragraphs (a), (b) or (c) of this question, although certain restrictions may apply in relation to other types of entities (such as the Crown and statutory corporations), particularly in relation to their power to enter into particular transactions and the assets of those entities available to satisfy particular kinds of obligations. Except as noted in paragraph 2.1 above, the types of Covered Collateral involved should not have any effect on enforcement rights considered in that paragraph.

In certain circumstances certain claims may rank in priority (either in whole or in part) to a security interest including, without limitation:

(a) claims for the costs of administration and realisation;

(b) certain claims mandatorily preferred by law; and

(c) certain claims arising by operation of law or specifically charged by statute (including, without limitation, local government rates and land tax),

but in this regard the position of the FCM is no different from any person taking similar security interests under Australian Law.

1.3 FCM in default

Question 12: How would your response to questions 10 and 11 change, if at all, assuming that an insolvency proceeding above has occurred with respect to the FCM (notwithstanding that the Covered Agreement may not provide for any events of default in respect of the FCM) rather than or in addition to the Covered Customer (for example, would this affect this ability of the FCM to enforce its security interest in Covered Collateral)?

If an insolvency proceeding has occurred is subsisting in relation to the FCM rather than the Covered Customer, our responses to questions 10 and 11 above would not change.

2 Enforcement of the Security Interest in Covered Collateral after the commencement of an insolvency proceeding

Note that the assumption in II.B.(e) of the Instructions in Annex 2 to this opinion applies to questions 13 to 15 below.

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2.1 Competing claims

Question 13: How are competing priorities between creditors determined in your jurisdiction? What conditions must be satisfied if the FCM's security interest in each type of Covered Collateral is to have priority over all other claims (secured or unsecured) of an interest in the Covered Collateral?

There are priority rules under the PPSA and the Corporations Act which apply to determine:

(a) the priority between competing security interests attached to the same collateral;

(b) in some cases, the priority between a security interest and another interest (such as that of a purchaser); and

(c) the priority of transitional securities.

Please see Schedule 5 with respect to the priority rules in the Corporations Act.

Close-out netting theory

As discussed in paragraph 2.6 of Schedule 3, where specified safeguards are met, the protection under the Netting Act of the enforcement of security (including the protection against the enforcement being void or voidable) applies despite:

() the creation of any encumbrance, or any other interest, in relation to the financial property secured; or

(a) the operation of any encumbrance, or any other interest, in relation to that financial property,

in contravention of a prohibition in the contract or in the protected security.[94]

[94] Section 14(2)(h) of the Netting Act. The amendment to section 14(2)(h) of the Netting Act made by the Collateral Protection Act does not apply to disposals of rights or property, or the creation or operation of encumbrances or interests, before 1 June 2016 (Collateral Protection Act, Part 3).

These protections apply despite any other law (including the "specified provisions"), but subject to applicable "specified stay provisions". The effect of this is considered further in our responses in paragraph 3.2 below.

2.2 Stay on rights

Question 14: Would the FCM's enforcement of its security interest in any type of Covered Collateral be subject to any stay, moratorium or freeze or otherwise be affected by commencement of the insolvency (that is, how does the institution of an insolvency proceeding change your response to question 10 above, if at all)?

Stay during administration

The effect of section 440B of the Corporations Act is that during the administration of an Australian Company, a security interest over the Australian Company's property cannot be enforced[95] except with the leave of the court or the administrator's written consent. A secured creditor holding security over substantially all of the assets of the Australian Company can effectively block the appointment of an administrator (this is because such a secured creditor has a 13 business day period after the appointment of an administrator to decide whether to enforce the security interest), but this exception allowing the secured creditor to act would *not* apply in the case of the security interest granted by the Covered Customer to the FCM (assuming that the collateral provided by the Covered Customer under the Covered Agreement does not comprise substantially all its assets).

Please also refer to paragraph 5 of Part D in relation to the Specified Stay Provisions.

95 "Enforce" is defined broadly by the Corporations Act to include, among other things, the exercise in relation to property of a right, power or remedy existing because of the security interest that arises (a) under an agreement or instrument relating to the security interest; (b) under an agreement or instrument relating to a transaction or dealing giving rise to the security interest (in the case of a PPSA security interest); (c) under a written or unwritten law; or (d) in any other way. Therefore, a secured party cannot resort to self-help measures that fall within the definition of "enforce" without the administrator's consent or leave of the court. This prohibition means that, amongst other restrictions, a secured party may not "liquidate" Collateral which is under its control at the time administration commences. This prohibition does not, however, prevent a person from giving a notice under the provisions of an agreement or instrument under which a security interest is created or arises.

Trust theory

Where the trust theory applies, please refer to paragraph 5 of Part D and paragraph 5.8 of Schedule 1 with respect to the ipso facto stays which, in our view and on the basis considered in paragraph 5.8 of Schedule 1, should not be relevant to that Clearing Agreement provided that the Customer Transactions are derivatives.[96]

Close-out netting theory

Where the close-out netting theory applies, to the extent that the Netting Act protects the enforcement of the security applies, it is subject to (i) any specified stay provision which is applicable to the Clearing Agreement; and (ii) sections 14(4) and 14(5) of the Netting Act (see paragraph 5.3 of Schedule 1).

With respect to the specified stay provisions, please see our discussion on this point in paragraph 3 of Part E. The analysis in that paragraph in respect of the circumstances in which non-direction stays may cease in relation to a close-out netting contract applies in relation to a security given over financial property, in respect of an obligation of a party to a close-out netting contract to which a regulated body or a related body corporate of a regulated body (in each case, as defined in the Netting Act) is a party,[97] in a substantially similar manner to the way in which it is described to apply in relation to a close-out netting contract.

Accordingly, the analysis in paragraph 3 of Part E applies equally to our response to this question as if the references in that paragraph to closing out transactions under a close-out netting contract, or to whether a party may or may not close out transactions under a close-out netting contract to which a regulated body or a related body corporate of a regulated body (in each case, as defined in the Netting

[96] As defined in Chapter 7 of the Corporations Act.

[97] Section 15A(2) of the Netting Act provides that section 15A of the Netting Act (which sets out the circumstances in which a non-direction stay may cease) "applies in relation to a security given over financial property, in respect of an obligation of a party to a close-out netting contract, if: (aa) a party to the contract is: (i) a regulated body; or (ii) a related body corporate of a regulated body; and (a) the obligation is an eligible obligation in relation to the contract, or an obligation of a prescribed kind; and (b) a specified stay provision (other than a direction stay provision) applies to a trigger event that happens in relation to the contract".

Act) is a party, were to enforcing security given over financial property, in respect of an obligation of a party to a close-out netting contract, or to whether the party may or may not enforce security under a security given over financial property in respect of an obligation of a party to a close-out netting contract (as applicable).

Please see paragraph 5.8 of Schedule 1 with respect to the ipso facto stays. In our view and on the basis considered in that paragraph, the ipso facto stays should not be relevant where the close-out netting theory applies as (a) the Clearing Agreement should be a close-out netting contract for the purposes of the Netting Act and (b) under the Clearing Agreement, security is given over financial property (within the meaning of the Netting Act) in respect of eligible obligations (within the meaning of that Corporation Act) of a party to a close-out netting contract.

2.3 Clawback

Question 15: Will the Covered Customer (or its administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official) be able to recover any transfers of Covered Collateral consisting of cash or securities made to the FCM during a certain "suspect period" preceding the date of the insolvency as a result of such a transfer constituting a "preference," fraudulent transfer or transaction at an undervalue (however called and whether or not fraudulent) in favour of the FCM or on any other basis? If so, how long before the insolvency does this suspect period begin? Would the posting of additional margin (which could be required when an Account's net liquidating equity has fallen below the required margin level for the Account due to trading losses in respect of one or more Covered Transactions) during the suspect period be subject to avoidance, either because the Covered Collateral was considered to relate to an antecedent or pre-existing obligation or for some other reason?

Under Australian insolvency laws, transactions may be void, voidable or vest in the grantor in certain circumstances, which are considered in Schedule 6 and paragraph 4.1 below.

Close-out netting theory

Where the close-out netting theory applies, to the extent that the Netting Act protects the enforcement of the security applies, the protection of enforcement applies despite any other law (including the

specified provisions), but subject to applicable specified stay provisions. The specified provisions are defined in the Netting Act to include many of the Australian insolvency laws referred to above. Further, even where such laws are not specified provisions, the Netting Act protection applies "despite any other law". Consequently, the Netting Act protection applicable to enforcement of security applies despite those Australian insolvency laws.

In addition, the enforcement of security which is protected under the Netting Act is not to be void or voidable in the external administration, subject to the application of either of the two limitations set out in paragraph 2.6 of Schedule 3.

2.4 Requirements where Australian Law is not the governing law for validity and perfection

Question 16: Assuming that (a) pursuant to the laws of your jurisdiction, the laws of another jurisdiction govern the creation and/or perfection of the security interest (for example, because such Covered Collateral is Located or deemed Located outside your jurisdiction) and (b) the FCM has obtained a valid and perfected security interest under the laws of such other jurisdiction, are there any formalities, notification requirements or other procedures, if any, that the FCM must observe or undertake in your jurisdiction in enforcing its security interest in Covered Collateral?

Note the additional assumption in II.B.(d) of the Instructions in Annex 2 to this opinion applies to questions 13 to 15 below.

If the laws of another jurisdiction govern the enforcement of the security interest, there are no other formalities, notifications or other procedures that the FCM must observe or undertake in Australia in exercising its rights as a secured party under the Security Interest.

3 Additional considerations

3.1 Other circumstances that might affect enforcement

Question 16: Are there any other local law considerations that you would recommend the FCM to consider in connection with enforcing its security interest in Covered Collateral?

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Additional issues regarding Australian companies which are superannuation trustees or Life Companies

Superannuation trustees and life companies are restricted by the *Superannuation Industry (Supervision) Regulations 1994* (Cth) ("***SIS Regulations***") and the Life Insurance Act from granting charges over regulated superannuation funds or approved deposit funds, or its statutory funds (respectively). Those restrictions are subject to limited exceptions, which were amended by the *Financial System Legislation Amendment (Resilience and Collateral Protection) Regulation 2016* (Cth) ("***Collateral Protection Regulation***"). The Explanatory Statement to the *Collateral Protection Regulation* states the following:

> "The [*Collateral Protection Regulation*] will:
>
> a) enable trustees of superannuation funds and approved deposit funds (Superannuation Funds) regulated under the SIS Act and life companies regulated under the Life Insurance Act to provide margin by way of security in relation to derivatives in the manner required to access international capital markets and liquidity; and
>
> b) update the list of approved bodies (being domestic and foreign exchanges and clearing houses) to whom trustees of Superannuation Funds and life companies may grant security.
>
> This is intended to allow those entities to access liquid global markets such as the United States cleared over-the-counter (OTC) derivatives market through Futures Commission Merchants (FCMs)".

The amended exceptions apply only where certain requirements that are set out in them are satisfied, consideration of which is beyond the scope of this opinion on enforceability of valid security arrangements. However, by way of summary, we note that these conditions include that the security is required by applicable law, or the rules of an "approved body" (which are markets and clearing houses listed in the regulations). There is also a further extension to allow charges to be given to secure obligations under derivative contracts over "financial property" which links to the changes made in the reform package to address global derivative margining requirements.

Accordingly, any Covered Agreement which contains any security interest (including the Security Interest) should not be used when the Covered Customer is a superannuation trustee or Life

Company unless legal advice is obtained that the type of security interest proposed is permissible under the applicable Australian statutes.

Circulating assets

Relevantly to intermediated securities, the test under the PPSA for whether an asset is a circulating asset (which means that the security interest over the asset will also be circulating) is the secured party must not have given the grantor express or implied authority for any transfer of the personal property to be made, in the ordinary course of the grantor's business, free of the security interest.

Under section 588FJ of the Corporations Act, if the Covered Customer is being wound up then a circulating security interest which is created within 6 months before the relation-back day (or after that date) is void as against the Covered Customer's liquidator except so far as it secures, essentially, the giving of some new benefit to the Covered Customer (such as an advance at or after the time the security interest was created) or if it is proved that the Covered Customer was solvent immediately after that time.

Where the close-out netting theory applies

Where the close-out netting theory applies, to the extent that the Netting Act protects the enforcement of the security applies, those protections apply despite any other law (including the "specified provisions"), but subject to applicable "specified stay provisions". Accordingly, our comments under the heading 'circulating assets' immediately above is not relevant where that protection applies.

General comments

Other factors which might affect an FCM's ability to enforce its security interest in Australia include the provisions of the Corporations Act dealing with transactions with related parties, the presence of fiduciary duties, whether or not the Base Account Agreement or CDA have been entered into for bona fide commercial reasons and on arm's length terms, the discretions of an Australian Court with respect to the availability of equitable remedies (including, without limitation, injunction and specific performance) and the effect of other rules of law and equity. Also, the rights of a party to enforce a document may be limited or affected by its own breaches or misrepresentations and its own unlawful

conduct (for example, if it did not hold authorisations which it is required to hold in order to conduct its business). In addition, claims of certain creditors are mandatorily preferred by law.

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Part H Qualifications and reliance

0 Qualifications

Following are a number of general qualifications to this analysis:

(a) We express no opinion on any provision of the Clearing Agreement or any provision set out in the S&C Memorandum or Summary Annex save for those provisions that we expressly opine upon in this opinion.

(b) Any external administration of the Customer commences after 1 June 2016.

(c) The rights of a counterparty to enforce a Clearing Agreement may be limited or affected by:

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

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

(iii) conduct of that party in relation to the Clearing Agreement which gives rise to an estoppel or claim against that party by the party against whom it is seeking to enforce its rights under the Clearing Agreement.

(d) An obligation which imposes a detriment on a party may be unenforceable in its entirety or to the extent that the detriment exceeds the amount of the relevant loss or damage, if that detriment is held to constitute a penalty.

(e) A party entering into a Clearing Agreement may, in doing so, be acting, or later be held to have acted, in the capacity of a trustee under an undocumented or partially documented constructive, implied or resulting trust which may have arisen as a consequence of that party's conduct.

(f) The availability of certain equitable remedies (including, without limitation, injunction and specific performance) is at the discretion of a court in the Australian Jurisdictions.

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(g) A provision in a Clearing Agreement that a statement, opinion, determination or other matter is final and conclusive will not necessarily prevent judicial enquiry into the merits of a claim by an aggrieved party.

(h) The question whether a provision of a Clearing Agreement or a transaction which is invalid or unenforceable may be severed from other provisions is determined at the discretion of a court in the Australian Jurisdictions.

(i) An indemnity for legal costs may be unenforceable.

(j) Any provision which states that amendments and waivers must be in writing to be effective may not preclude oral amendments or waivers.

(k) Court proceedings may be stayed if the subject of the proceedings is concurrently before a court.

(l) A court will not give effect to a choice of laws to govern a Clearing Agreement or a submission to the jurisdiction of certain courts if to do so would be contrary to public policy in the Australian Jurisdictions. However, we consider it is very unlikely that a court would reach such a conclusion in relation to New York law.

(m) A document may not be admissible in court proceedings unless applicable stamp duty has been paid.

(n) No view is expressed as to penalty interest, post-insolvency interest, conclusivity clauses, the availability of specific performance or injunction, the efficacy of liability exculpation clauses, severability clauses or indemnities for litigation costs.

(o) No view is expressed as to the accuracy, completeness or suitability of any formula set out in any Clearing Agreement. If any formula is inaccurate, incomplete or unsuitable for the purpose of determining the amounts or matters for which it has been included, then a court may find that the relevant formula is void for uncertainty.

(p) The nature and enforcement of rights and obligations may be affected by lapse of time, failure to take action or laws (including, without limitation, laws relating to the enforcement of security interests), certain equitable remedies or defences generally affecting creditors' rights.

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(q) The term "enforceable" as used in this opinion means that the obligations assumed are of a type which courts of the Australian Jurisdictions enforce. It does not mean that these obligations will necessarily be enforced in the circumstances or in accordance with their terms in that the power of the courts of the Australian Jurisdictions to order specific performance of an obligation or to order any other equitable remedy is discretionary and, accordingly, such a court might make an award of damages where specific performance of an obligation or any other equitable remedy was sought.

(r) The laws of the Australian Jurisdictions may require that:

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

(ii) discretions are exercised reasonably; and

(iii) opinions are based on good faith.

(s) The *Charter of the United Nations (Dealing with Assets) Regulations 2008* (Cth) and other regulations in Australia restrict or prohibit payments, transactions and dealings with assets having a prescribed connection with certain countries or named individuals or entities subject to United Nations sanctions or associated with terrorism. As at the date of this opinion, no such approvals are required in respect of payments or transactions between Australia and the United States of America.[98]

(t) As a matter of law of the Australian Jurisdictions, claims may become barred under the Limitation Acts or may be or become subject to setoff or counterclaim.

(u) We have not reviewed any of the terms of the Transactions entered into, or to be entered into, between the FCM and the DCO (or Foreign Futures Broker) and express no opinion on them.

(v) The statutory regime governing personal property securities and the enforcement of security given over financial property in Australia incorporates new concepts into Australian Law many of

[98] The countries, individuals and entities that require approval change from time to time. As at the date of this opinion, these listings are maintained by the Australian Department of Foreign Affairs and Trade at https://www.dfat.gov.au/.

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which, as of the date of this opinion, have not been the subject of detailed analysis in Australian Courts.

(w) The analysis in this opinion is restricted to the position where the relevant insolvency proceedings in respect of the Customer are governed by Australian Law. We express no opinion as to whether Australian Law would, in fact, govern such proceedings, whether or not conducted in the Australian Courts.

(x) We are not qualified to give, and have not given, accounting or auditing advice and nothing in this opinion is to be interpreted otherwise.

(y) Any provision of the relevant Clearing Agreement (or the DCO rules (or clearing agreement between the FCM and the Foreign Futures Broker) that it is subject to) stating that a failure or delay on the part of any party in exercising any right or remedy shall not operate as a waiver of such right or remedy may not be effective.

(z) We do not express any opinion as to any taxation matters (including stamp duty).

(aa) An Australian Court may, or may be required to, stay proceedings or decline jurisdiction in certain circumstances - for example, if proceedings are brought elsewhere.

(bb) No view is expressed as to any of the following:

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

(ii) any law which has been enacted and has not commenced, or if it has commenced, has not started to apply;

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

(iv) the implications of any of them.

1 Addresses of this opinion, purpose and reliance

This opinion of law is addressed to the FIA and ISDA solely for their benefit and the benefit of their members in relation to their use of the Covered Agreement. No other person may rely on this opinion for any purpose without our prior written consent. This opinion may, however, be shown by the FIA,

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~~International Swaps and Derivatives Association, Inc and Futures Industry Association 8 August 2017~~

ISDA, an FIA member or an ISDA member to a competent regulatory or supervisory authority or professional advisors for such member, the FIA or ISDA for the purposes of information only, on the basis that we assume no responsibility to such authority or any other person as a result, or otherwise.

* * * * * * *

Yours faithfully

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SCHEDULE 1

SUMMARY OF THE NETTING ACT

In this opinion, we are only concerned with the effect of Part 4 of the Netting Act, which deals with 'close-out netting contracts'.

0 What is a 'close-out netting contract'?

The Netting Act defines a "close-out netting contract" as follows:

> "(a) a contract under which, if a particular event happens:
>
> (i) particular obligations of the parties terminate or may be terminated; and
>
> (ii) the termination values of the obligations are calculated or may be calculated; and
>
> (iii) the termination values are netted, or may be netted, so that only a net cash amount (whether in Australian currency or some other currency) is payable; or
>
> (b) a contract declared by the regulations to be a close-out netting contract for the purposes of this Act;
>
> but does not include:
>
> (c) a contract that constitutes, or is part of, an approved netting arrangement; or
>
> (d) a contract in relation to which a declaration under section 15 is in force; or
>
> (e) a contract declared by the regulations to not be a close-out netting contract for the purposes of this Act."

Subsection (c) is designed to prevent overlap with other sections of the Netting Act dealing with netting arrangements used by Australian clearing banks and approved by the Reserve Bank of Australia. These other sections are inapplicable to the Covered Base Agreements and CDAs. Subsections (d) and (e) are designed to provide a mechanism for specific contracts to be excluded either by a declaration by the Reserve Bank of Australia (on the basis of risk of systemic disruption)

or by regulation passed under the Netting Act. After inquiry we are not aware of any such declarations or regulations.[99]

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

Section 14(1) of the Netting Act, which deals with the operation of close-out netting prior to external administration, applies only if, relevantly, Australian law governs the 'close-out netting contract'. Accordingly, we do not consider section 14(1) further in this opinion.

2 The effect of the Netting Act on 'close-out netting contracts' during external administration

Section 14(2)(c) of the Netting Act provides that, in respect of a 'close-out netting contract', where a party goes into 'external administration':

(a) obligations under a 'close-out netting contract' may be terminated;

(b) termination values may be calculated; and

(c) a net amount become payable,

in accordance with the 'close-out netting contract'.

Section 5 of the Netting Act provides that:

> "a person goes into external administration if:
>
> (a) they become a body corporate that is a Chapter 5 body corporate within the meaning of the [Corporations Act]; or

[99] In addition, the explanatory memorandum published by the Commonwealth Government when the Bill to enact the *Netting Act* was introduced in Federal Parliament states that: "It is envisaged that the Reserve Bank would make a declaration under [section] 15 in only the most exceptional circumstances".

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(b) they become an individual who is an insolvent under administration; or

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

(d) an ADI statutory manager takes control of the person's business under the [Banking Act]; or

(e) the person comes under judicial management under the [Insurance Act]; or

(f) the person, or a part of the person's business, comes under judicial management under the [Life Insurance Act]."

Each of the insolvency proceedings to which an Australian Company may be subject fall under Australian law and which are identified in paragraph 3.2 of Part A fall within the definition of "external administration" in the Netting Act.

Each of these proceedings is also governed by Australian law. As a result section 14(2) of the Netting Act is applicable on the occurrence of each of these proceedings.

In addition, subsections 14(2)(d) to (f) of the Netting Act provide that:

(i) obligations that are, or have been, netted or terminated under the 'close-out netting contract' are to be disregarded in the external administration;

(ii) any net obligation owed by the party under the 'close-out netting contract' that has not been discharged is provable in the external administration; and

(iii) any net obligation owed to the party under the 'close-out netting contract' that has not been discharged may be recovered by the external administrator for the benefit of creditors.

Section 14(2)(g) provides that, relevantly, the netting or termination of obligations under the contract and a payment made by a party to discharge a net obligation under the contract are not to be void or voidable in the external administration of that party.

The protection afforded to close-out netting under the Netting Act applies despite, relevantly:

- any disposal of rights that may be netted under the contract; or

- the creation of any encumbrance, or any other interest, in relation to those rights; or
- the operation of any encumbrance, or any other interest, in relation to those rights,

in contravention of a prohibition in the contract or the security.[100] The inclusion of this provision was intended to ensure that close-out netting on an external administration is not affected by the interests of third parties which arise in contravention of a prohibition in the contract, subject to any specified stay provision that applies to the contract.[101]

3 Constitutional reach of the Netting Act

The Commonwealth of Australia is a federation of the various Australian States and Territories. The power of the Commonwealth government (as opposed to the State governments) is limited by reference to specific heads of power in the Constitution of Australia. Section 14 of the Netting Act was drafted with the intention that it only applies to 'close-out netting contracts' which can be regulated pursuant to the Commonwealth's constitutional power.

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

(a) Australian law governs the 'close-out netting contract'; or

(b) Australian law governs the external administration.

As we have assumed that the Clearing Agreement will be governed by New York law, the application of the Netting Act to the external administration of an Australian Company will depend upon the external administration being governed by Australian law (in respect of which, please see our comments in paragraph 3 above).

[100] Section 14(2)(h) of the Netting Act. The term "the security" refers to a security given over financial property, in respect of obligations of a party to the close-out netting contract, and is considered in more detail in Part C of this opinion. Section 14(2)(h) of the Netting Act does not apply to disposals of rights or property, or the creation or operation of encumbrances or interests, before 1 June 2016.

[101] 2016 Explanatory Memorandum, [1.124].

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

4.1 Section 14(4)

Under section 14(4), a person may not rely on the application of section 14(2) to a right or obligation under a close-out netting contract if:

(a) the person acquired the right or obligation from another person with notice that that other person, or the other party to the contract, was at the time unable to pay their debts as and when they became due and payable; and

(b) the person acquired the right or obligation otherwise than as a result of the operation of section 22, 35 or 36R of the *Financial Sector (Business Transfer and Group Restructure) Act 1999* (Cth) ("**Business Transfer Act**").

The expression "acquiring" in the context of a transaction is intended to mean both obtained by grant or creation and by transfer.[102]

Accordingly, any profit or loss arising in respect of a transaction acquired by a solvent party at a time when the solvent party had notice of the insolvent party's insolvency will not be permitted to be netted against profits and losses under other transactions.

4.2 Section 14(5)

Section 14(5) of the Netting Act provides that section 14(2) of the Netting Act does not apply to an obligation owed by a party to a close-out netting contract to another person if:

(a) the party goes into external administration; and

(b) the party acquired the obligation otherwise than as a result of the operation of section 22, 35 or 36R of the Business Transfer Act; and

(c) section 14(6) of the Netting Act is satisfied.

[102] 2016 Explanatory Memorandum, [1.174].

Section 14(6) is satisfied if any of the following are satisfied:

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

(ii) when that transaction was entered into, the other person had reasonable grounds for suspecting that the party was insolvent at that time or would become insolvent because of, or because of matters including:

(A) entering into the transaction; or

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

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

It follows that it is important for the FCM seeking to rely on the Close-out Netting Rights, and rights relating to the enforcement of security, that it:

- enters into each transaction in good faith. Good faith would be absent if there were fraud or if there subsisted an intention on the part of the party to obtain an advantage vis a vis the other creditors of the Australian Company. A transaction entered into as part of the ordinary course of business would not of itself result in the inference that there was an absence of good faith;
- at the time when it became a party to the transaction, the party had no reasonable grounds for suspecting that the Australian Company was insolvent (in the sense that the Australian Company was unable to pay all its debts as and when they become due and payable) or would become insolvent if it entered into the transaction. The notion "reasonable grounds for suspecting" embodies something which, in all the circumstances, would create in the mind of a reasonable person in the position of the party (as payee) an actual apprehension or fear that the Australian Company was unable to pay its debts when they became due and payable. The notion also embodies a mistrust of the Australian Company's ability to pay its debts as they become due, and an appreciation of the advantage which the party's acceptance of the payment would have as between the party and other creditors of the Australian Company; and

- provided valuable consideration under the transaction or changed its position in reliance on the transaction. In this context, the valuable consideration must be real and not colourable, in the sense of being contrived or without substance. In our view, the incurrence of the mutual obligations of each party to a transaction to make payments or deliveries would constitute valuable consideration for these purposes.

4.3 Application of subsections 14(4) and 14(5) of the Netting Act to security arrangements

If security is given over financial property, in respect of obligations of a party to a close-out netting contract, then the subsections 14(4) and 14(5) of the Netting Act as described above each applies in relation to rights and obligations under the security (or an obligation owed by a party to the security) in the same way as it applies in relation to rights and obligations under (or an obligation owed by a party to) the contract.[103]

4.4 Relationship with other law (other than the PPSA and the specified stay provisions)

Section 14(3) of the Netting Act provides that section 14(1) and section 14(2) have effect in relation to a close-out netting contract "despite any other law (including the specified provisions)", but subject to any specified stay provision that applies to the Clearing Agreement. A specified stay provision which applies to a close-out netting contract will prevent the contract or a counterparty from, relevantly, closing out transactions relating to the contract on the grounds discussed in the relevant specified stay provision. However, a specified stay provision does not prohibit a counterparty from closing out transactions relating to the Clearing Agreement for any other reason. The specified stay provisions are considered in Schedule 4 and paragraph 3 in Part E.

The 2016 Explanatory Memorandum explained that the "specified provisions" definition is an inclusive list of the provisions of other laws over which the Netting Act prevails and is inserted for transparency and ease of reference. The laws included in the definition of "specified provisions" include laws providing for the following:

[103] Section 14(9) of the Netting Act.

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- the assets of Australian banks and other authorised deposit-taking institutions being available to meet the obligations to depositors before other creditors (section 13A(3) of the Banking Act);
- the assets of foreign authorised deposit-taking institutions in Australia being available to meet Australian liabilities before other liabilities (section 11F of the Banking Act);
- the priority of an Australian bank's debts to the Reserve Bank of Australia over the other debts owed by the bank (other than those owed to depositors);
- the allocation of assets of a life company on its insolvency; and
- the winding up or dissolution of trustees of superannuation entities.

Specific reference is also made to the insolvency provisions of the Corporations Act (essentially those provisions concerning voidable and void transactions) and certain provisions of the *Bankruptcy Act 1966* (Cth). A note is made in the legislation to the effect that the express recognition given to close-out netting in sections 14(1) and 14(2) of the Netting Act is to remove the basis for arguing that close-out netting contracts are void as contrary to public policy embodied in insolvency law.

The term "specified provisions" also includes the references to sections of the following Acts:

- the Banking Act, Insurance Act and the Life Insurance Act.[104] These provisions were included to clarify that the protections afforded in the Netting Act prevail over the regimes set out in those Acts which allow for counterparties under a contract with an ADI, general insurer, or life company (or other specified entity) to be relieved of their obligations under that contract if the regulated entity is prevented from fulfilling its contractual obligations. In other words, the counterparty can close-out transactions under the contract, rather than being merely relieved of their obligations under the contract.[105]

[104] Sections 230C(2) and (3) of the Life Insurance Act; sections 105(2) and (3) of the Insurance Act; sections 11CD(2) and (3) of the Banking Act.

[105] 2016 Explanatory Memorandum, [1.165].

- the PPSA and the Corporations Act, which were included to clarify that the protection afforded in the Netting Act would prevail over these provisions of those Acts, which may otherwise impose a stay on enforcement of security in certain circumstances (section 440B of the Corporations Act), which set out certain priority payments (section 556 of the Corporations Act) and which provide for circumstances in which security interests will vest (section 588FL of the Corporations Act and sections 267 and 267A of the PPSA).[106]

4.5 Interaction with the PPSA

Please see Schedule 2 with respect to the PPSA.

Were it not for an applicable exclusion from the PPSA, the breadth of the definition of "security interest" under the PPSA could encompass the close-out netting provisions of a close-out netting contract.

The exclusion from the PPSA which is particularly relevant to close-out netting is in section 8(1)(e), which provides that the PPSA does not apply to any right or interest held by a person, or any interest provided for by any transaction, under, relevantly, a close-out netting contract.

~~(iii) a market netting contract;"~~

~~The close-out netting contracts exclusion is not limited only to the right to close-~~The exclusion is not expressly limited only to the right to close out and net obligations. However, in our view, the close-out netting contracts exclusion is not so extensive that it excludes any interest which happens to be created under either the terms of a close-out netting contract or a transaction under that close-out netting contract. Such an interpretation would, for example, exclude from the operation of the PPSA interests created under a charge if the terms of that charge were included within the ~~body~~ terms of the ~~Covered Base Agreement or CDA~~close-out netting contract. Rather, we consider that the close-out netting contract exclusion excludes from the operation of the PPSA rights and interests which are either:

[106] 2016 Explanatory Memorandum, [1.167].

- rights and interests which are created, and held, solely under and as an elemental part of a close-out netting contract; or
- interests created by transactions under a close-out netting contract if those transactions (and therefore those interests) are subject to the close-out netting process contained in that close-out netting contract.

Another way of describing this is that a provision within the body of a close-out netting contract which creates a security interest in relation to personal property which is "outside" of the close-out netting contract and which survives close-out netting should fall outside of the close-out netting contract exclusion, and thus is capable of being a security interest for the purposes of the PPSA.

We consider that this interpretation is consistent with the wording and purpose of the close-out netting contract exclusion whilst also avoiding an operation of the provision which could frustrate the operation of the PPSA. It is also important to note that it is possible for particular transactions to themselves give rise to a security interest under the PPSA.

Accordingly, we would expect that the close-out netting exclusion is effective to exclude any security interest created by the close-out netting provisions of the Covered Base Agreement or CDA a close-out netting contract from the operation of the PPSA. This can be seen also by the presence of another section of the PPSA which provides that the Netting Act prevails over the PPSA to the extent of any inconsistency. This provision has the effect of rendering close-out netting in accordance with the Netting Act effective despite the PPSA.

In addition, we would expect that the set-off exclusion is effective to exclude any security interest created by the Contractual Set-off Rights from the operation of the PPSA.

It is also important to note that it is possible for particular transactions to themselves give rise to a security interest under the PPSA. An example of this is if a transaction gave rise to a deemed security interest such as the absolute transfer of an account (we mentioned this deemed security interest in paragraph C.I.2.2 below).

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PART C: ELIGIBLE COLLATERAL UNDER A COVERED BASE AGREEMENT AND CDA

I INTRODUCTION

1 Overview of collateral laws in Australia

For the purposes of this memorandum, there are two key pieces of legislation relevant to the validity and enforcement of collateral arrangements under the Credit Support Documents under Australian Law. These are the PPSA and the *Netting Act*. In this memorandum, we summarise the relevance of the PPSA and the *Netting Act* to collateral arrangements in paragraphs C.I.2 to C.I.3 and then consider the application of these laws to the specific questions raised in the Instruction Letter in Parts C.II to C.V.

4.6 Specified stay provisions

Please see our comments in paragraph 3 of Part E and Schedule 4 with respect to the specified stay provisions.

4.7 Retroactivity of the Netting Act

Subject to the paragraph below and Schedule 3 and Schedule 4, the Netting Act has effect in respect of a close-out netting contract which takes place after 2 July 1998.[107] This is the case even where the Clearing Agreement was entered into prior to this date. However, the Netting Act will not affect close-out netting which took place prior to 2 July 1998.[108]

[107] However, section 14(2)(h) of the Netting Act does not apply to disposals of rights or property, or the creation or operation of encumbrances or interests, before 1 June 2016.

[108] There is a technical argument that the Netting Act will not be effective where its operation purports to deprive a person of property other than on just terms (because of section 51(xxxi) of the Constitution of the Commonwealth of Australia). This could be the case where a third party has taken a valid interest in an obligation owing under a Clearing Agreement and the Netting Act has the effect of terminating that obligation and, as a result, the third party's interest.

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4.8 Ipso facto regime

Relevantly and in summary, the effect of the so-called 'ipso facto' regime in the Corporations Act is that "ipso facto" rights cannot be enforced against a body, corporation or company (as applicable) due to:

(a) the entity becoming subject to administration;

(b) a managing controller (that is, a receiver or other controller with management powers or functions) being appointed to the whole or substantially the whole of the entity's property;

(c) the occurrence of certain events related to the entity being the subject of a compromise or arrangement (eg the entity is subject to an application for or a scheme of arrangement for the purpose of avoiding being wound up in insolvency (or if it is a disclosing entity, has publicly announced that it will be making such an application));

(d) the entity's financial position, if the entity is subject to the events referred to in paragraphs (a) to (c) above; or

(e) a reason that, in substance, is contrary to a subsection imposing an ipso facto stay.

Broadly, an "ipso facto" right refers to a right that arises under an express provision (however described) of a contract, agreement or arrangement upon the occurrence of some specific event, regardless of the continued performance of the counterparty.

These stays on enforcement will apply in relation to rights arising under, or self-executing provisions of, contracts, agreements or arrangements entered into at or after 1 July 2018.

However, the amendments to the Corporations Act expressly provide that the Netting Act prevails over the ipso facto reforms referred to immediately above to the extent of inconsistency, and the amendments to the Netting Act provide for the stay provisions referred to above to be included in the definition of "specified provisions" in the Netting Act.

Further, the amendments to the Corporations Act also provide that regulations may be made under that Act which may, amongst other things, prescribe that the stays do not apply to a right contained in a kind of contract, agreement or arrangement prescribed in the regulation. The *Corporations*

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Amendment (Stay on Enforcing Certain Rights) Regulations 2018 (Cth) which commenced on 1 July 2018 exclude from the scope of the ipso facto stays, relevantly:

() a contract, agreement or arrangement that is, or is directly connected with, a derivative;[109]

(i) a contract, agreement or arrangement that is, or is directly connected with, a securities financing transaction;

(ii) a contract, agreement or arrangement that is, or governs, securities, financial products, bonds, promissory notes, or syndicated loans;

(iii) a close-out netting contract (within the meaning of the Netting Act); and

(iv) a contract, agreement or arrangement under which security is given over financial property (within the meaning of the Netting Act) in respect of eligible obligations (within the meaning of that Corporation Act) of a party to a contract covered by paragraph (iv) immediately above.[110]

Close-out netting theory

Where the close-out netting theory applies and the Clearing Agreement is a close-out netting contract, the ipso facto regime should not apply to the Clearing Agreement, on the basis that the Clearing Agreement should fall within the exclusion in paragraph (iv) above.

Trust theory

Where the trust theory applies, the ipso facto stays should not be relevant to that Clearing Agreement provided that the Customer Transactions are derivatives, on the basis that the Clearing Agreement should then fall within the exclusion in paragraph (i) above.

[109] As defined in Chapter 7 of the Corporations Act.

[110] Regulation 5.3A.50(2)(g), (h), (i), (zh) and (zi) of the *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018* (Cth).

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SCHEDULE 2
THE PPSA

The PPSA is fundamental to collateral arrangements under Australian Law, establishing By way of background, the PPSA has established a national system for the registration of security interests in personal property, together with rules for the creation, priority and enforcement of security interests in personal property.

Part 4 of the *Netting Act* protects the process under close-out netting contracts by which particular obligations of the parties terminate or may be terminated, the termination values of the obligations are calculated or may be calculated and the termination values are netted, or may be netted, so that only a net cash amount (whether in Australian currency or some other currency) is payable. This protection is considered further in Part B of this memorandum.

In 2016, the *Netting Act* was amended to protect the enforcement of security under security-based collateral arrangements where specified safeguards are satisfied. [22]The *Netting Act* protection overrides existing laws relating to the enforceability, validity and perfection of security interests, priority frameworks and any vesting which could otherwise occur under the PPSA or the *Corporations Act* due to non-perfection or a delay in perfection.[23] These amendments were made to ensure that entities subject to Australian Law can enforce rights in margin provided by way of security in the manner contemplated by the revised margin requirements for non-centrally cleared derivatives published by the Basel Committee on Banking Supervision and the International Organization of Securities Commissions in March 2015. As a facilitative enforcement regime, the *Netting Act* protection does not limit or otherwise restrict anything which would otherwise be available or protected at law (including

[22] *2016 Explanatory Memorandum*, [1.25]. In order for the *Netting Act* protection to apply to the enforcement of security, a number of conditions need to be met, including that the collateral must be transferred or otherwise dealt with before enforcement so as to be in the possession or under the control of the Clearing Member, or another person (who is not the Covered Customer) on behalf of the Clearing Member. These conditions are considered further in paragraph C.I.3 below.

[23] The *Netting Act* protection of enforcement of security applies "despite any other law (including the specified provisions)" but "subject to a specified stay provision that applies to the contract"; see also *2016 Explanatory Memorandum*, [1.114].

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any rights which a secured party would otherwise have by virtue of the PPSA, the exercise of those rights and any protection which applies to those rights or the exercise of those rights).[24]

However, there are circumstances where the *Netting Act* protection of the enforcement of security will not apply. These are described in this memorandum and they include, but are not limited to, circumstances where:

(a) the Clearing Member seeks to enforce the security under the Covered Base Agreement or CDA against the Covered Customer prior to the time when either party is subject to external administration governed by Australian Law. As we assume that the Covered Base Agreement and CDA entered into by the Covered Customer and the Clearing Member is governed by New York law, the *Netting Act* protection only applies if, at the time of the enforcement, either party is subject to external administration governed by Australian law. As a consequence, the steps for attachment and perfection under the PPSA continue to be relevant to an enforcement of security prior to any such external administration; or

(b) the Covered Base Agreement or CDA (as applicable) does not satisfy the definition of close-out netting contract (in respect of which, please see paragraph B.2.6 of this memorandum); or

(c) any of the conditions of the application of the *Netting Act* are not met. These include the constitutional limits on the application of the *Netting Act* as set out in Schedule 3 of this memorandum (as referred to in paragraph (a) above), and the particular conditions for protection of the enforcement of security (discussed in more detail in paragraph C.I.3 below).

Accordingly, we recommend in this memorandum that the applicable steps for attachment and perfection under the PPSA are taken, even where it is expected that the conditions for the application of the *Netting Act* protection for the enforcement of security will be satisfied. The steps for attachment

[24] *2016 Explanatory Memorandum*, [1.109].

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and perfection under the PPSA continue to be relevant to an enforcement of security where the *Netting Act* does not apply, including in any of the circumstances identified above.

We have noted in each response in this Part C the extent to which our answer differs where the *Netting Act* protection applies.

2 The Personal Property Securities Act

2.1 Summary of relevant requirements under PPSA

The PPSA is fundamental to collateral arrangements under Australian Law. The system is modelled on the personal property regimes in New Zealand, Canada and the United States. Some of the aspects of the PPSA which are most relevant to this memorandum are considered below.

The PPSA established a national system for the registration of security interests in personal property, whether given by a company or a natural person, together with new rules for the creation, priority and enforcement of security interests in personal property. It has replaced certain existing Australian Commonwealth and State based regimes co-ordinated by the Australian Securities and Investments Commission ("**ASIC**") and other regulators, including the previously existing regime under the *Corporations Act* for registration of charges. It also makes registrable as security interests certain transactions which were previously not registrable at all.

The PPSA commenced operation on 15 December 2009, and had operational effect from 30 January 2012 with a two year transitional period beginning at that time.

2.2 Personal property

The PPSA applies to security interests in personal property. Personal property means property other than land or a right, entitlement or authority that is granted under an Australian Law and other than property which is declared not to be personal property for the purposes of the PPSA.

A The PPSA defines a security interest is defined as an:

"interest in personal property provided for by a transaction that, in substance, secures payment or performance of an obligation".[111]

The form of the transaction, or the identity of the person who has title, is irrelevant.

There are some key elements of the general definition of security interest which are particularly relevant to the analysis in this ~~memorandum~~opinion. For there to be a security interest under this general definition:

() •(*secured obligation*) there must be an obligation to be paid or performed;

(i) •(*security*) the payment or performance of that obligation must be secured "in substance";

(ii) •(*personal property*) that security must be an interest in personal property; and

(iii) •(*transaction*) that interest must be provided for by a transaction.

Security interests for the purposes of the PPSA include traditional securities such as charges and mortgages. However, they also include transactions that, in substance, secure payment or performance of an obligation but which may not have been formerly legally classified, or even thought of commercially, as security interests (for example, transfers of title and flawed asset arrangements).

~~**2.3 PPSA collateral classes**~~

~~The steps for attachment and perfection of a security interest in personal property depend on the PPSA collateral class attributed to the personal property for the purposes of the PPSA.~~

~~In accordance with the Instruction Letter, we assume that the Eligible Collateral under the Covered Base Agreement and CDA includes the Covered Customer's (i) contractual rights under Futures Transactions and Cleared Derivatives Transactions, (ii) its contractual rights to payment in respect of Futures Transactions and Cleared Derivatives Transactions (whether obligations of the Clearing Member, a DCO, a foreign clearing member or a foreign clearing house) and (iii) the proceeds of such rights.~~

[111] Section 12(1) of the PPSA.

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Based on the assumptions which we have been asked to make for the purposes of this memorandum, the Eligible Collateral should fall within the PPSA collateral classes:

Eligible Collateral	**PPSA collateral class**
Directly held bearer debt security	Negotiable instrument or an investment instrument
Directly held registered debt security	Investment instrument
Directly held dematerialized debt security	Negotiable instrument or an investment instrument
Indirectly held debt security held through: **Annex 1** a custodian or nominee with an Australian financial services licence ("**AFSL**") or licence under a foreign jurisdiction permitting them to maintain securities accounts; **Annex 2** a clearing system such as Austraclear Limited ("**Austraclear**"), Euroclear Bank S.A./N.V. ("**Euroclear**") or Clearstream Banking, société anonyme, Luxembourg ("**Clearstream**");[25] or **Annex 3** CHESS.	Intermediated security
Indirectly held debt security held through an intermediary not listed above	Intangible property
Cash collateral that is subject to the security interest	Account or intermediated

[25] We assume that Euroclear and Clearstream each hold a licence issued under the law of a foreign jurisdiction permitting it, in the course of business or other regular activity, to maintain securities accounts on behalf of others.

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Eligible Collateral	**PPSA collateral class**
	security[26] [27]
Contractual rights under Futures Transactions and Cleared Derivatives Transactions	Investment instrument or intangible property
Contractual rights to payment from the Clearing Member, DCOs, foreign clearing members and foreign clearing houses in respect of Futures Transactions and Cleared Derivatives Transactions.	Investment instrument or intangible property
Rights to variation margin payments made by DCOs to the Clearing Member	Intangible property
Rights associated with any of the above collateral, including dividends, payment rights arising on conversion or redemption and rights in liquidations or schemes of arrangement (including proceeds of contractual rights to payment from the Clearing Member, DCOs, foreign clearing members and foreign clearing houses).	Proceeds

This memorandum does not address other types of collateral.

The classification of directly held bearer or dematerialized securities depends on whether or not they are negotiable, on the basis that:

- negotiable instruments are bills of exchange, cheques, promissory notes, letters of credit and any other writing that evidences a right to payment of currency if the writing is of a kind that, in the ordinary course of business, is transferred by delivery with any necessary

[137] *Dicey, Morris and Collins on The Conflict of Laws*, 14th Edition, p 1125.

[27] If the cash collateral is recorded in the same securities account as the indirectly held debt securities referred to above then it is likely to fall within the same characterisation.

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endorsement or assignment, or the writing satisfies the requirements for negotiability under the law governing the negotiable instruments; or

- investment instruments are, relevantly, debentures of a body (which commonly means a body corporate or an unincorporated body), debentures or bonds issued or proposed to be issued by a government, derivatives, foreign exchange contracts, interests in, or units in an interest in, managed investment schemes and other specified financial products, but do not include negotiable instruments.

The classification of indirectly held debt securities held in an account with an intermediary will depend on the licensing position of the intermediary. This is because intermediated securities are the rights of a person in whose name an intermediary maintains a securities account. A securities account is defined as:

- an account to which interests in financial products may be credited or debited; or
- in the case of an intermediary that operates a clearing and settlement facility under an Australian CS Facility licence, a record of holdings and transfers of interests in financial products.

In this context, financial products are, relevantly, bonds, any other financial instrument and any other financial asset (other than cash), or any interest in any of them.

An intermediary is defined as a person:

- who holds an AFSL or licence under the law of a foreign jurisdiction permitting them to maintain securities accounts on behalf of others; or
- who operates a clearing and settlement facility under an Australian CS Facility Licence,

but does not include a central bank. On this basis, the following securities will be intermediated securities:

- securities held by a custodian or nominee with an AFSL or licence under a foreign jurisdiction permitting them to maintain securities accounts. If the custodian or nominee

does not hold a licence (including if it does not need to under laws applicable to it), or is a central bank, then the rights of the account holder will be intangible property instead; and

- securities held in a clearing system such as Austraclear and Clearstream either:
  - directly - this will be the case where the securities are held by a person who is a member of the clearing system in a securities account; and
  - indirectly - this will be the case where the securities are held on behalf of a person by a custodian or nominee that is a member of the clearing system and that has an AFSL or licence under a foreign jurisdiction permitting them to maintain securities accounts.

If the person that maintains the securities account does not hold a licence (including if it does not need to under laws applicable to it) then the rights of the account holder will not be intermediated securities. In the case of debt securities, they should be intangible property instead.

2.4 PPSA does not displace other laws

The PPSA contains express provisions which clarify its relationship with other laws. These provide that:

- the PPSA is not intended to exclude or limit the operation of Australian Commonwealth or State laws, or the general law of Australia,[28][112] to the extent that they are capable of operating concurrently with the PPSA;
- specific Australian laws, such as the Netting Act, prevail over the PPSA to the extent of any inconsistency; and
- the PPSA prevails over laws of the Australian States and Territories which require or enable a person to register a security interest or an assignment of a security interest, the form in which the security agreement must take, or the attachment or perfection of security interests.

[28][112] The PPSA defines the general law as the principles and rules of the common law and equity.

2.5*Jurisdictional* application of the PPSA*reach*

The PPSA contains jurisdictional provisions which define the application of the Act PPSA to a security interest by reference to a connection with Australia. It provides that the PPSA applies to a security interest, relevantly:

(a)(I) in any class of personal property if the grantor of the security interest is an Australian entity, which includes an "Australian Company" (as defined in paragraph A.1.2(c) 4 of Part A above); and

(b)(II) otherwise, in

:(i) a negotiable instrument or an investment instrument, if it is located in Australia;

(ii) , relevantly, an intermediated security, if the intermediary is located in Australia; and.[113]

(iii) intangible property (including an account) if, relevantly:

(A) it is an account that is payable in Australia; or

(B) it is created, arises or is provided for by a law of Australia (including the general law).[29]

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[113] There is a technical threshold issue to consider in relation to these provisions, being whether they are intended to be exclusive or inclusive. In other words, should these provisions be construed on the basis that the PPSA applies only to these security interests, or that it does apply to those security interests and may also apply to others. The drafting of the PPSA is not completely clear on this point. In our view, the effect of these provisions should be that the PPSA does not apply to security interests which are not described in these provisions. This is because the intention of the section appears to be to define the jurisdictional connection needed for the PPSA to apply, rather than specifying examples of when it does apply. Examples of this can be found in the Explanatory Memorandum for the *Personal Property Securities Bill 2009* and its second reading speech. Also, this approach is consistent with the legislative principle that some connection (which could be remote, or general) between the subject matter of the legislation and the jurisdiction of legislation is needed for legislation to be valid and the presumption of statutory interpretation that legislation is not intended to have an extra-territorial effect unless a contrary intention is expressed.

[29] There is a technical threshold issue to consider in relation to these provisions, being whether they are intended to be exclusive or inclusive. In other words, should these provisions be construed on the basis that the PPSA applies ***only*** to these security interests, or that it does apply to those security interests and may also apply to others. The drafting of the PPSA is not completely clear on this point. In our view, the effect of these provisions should be that the PPSA does not apply to security interests which are not described in these provisions. This is because the intention of the section appears to be to define the jurisdictional connection

The PPSA sets out rules for determining which entities are Australian entities and the location of entities and property. These are important for understanding its jurisdictional provisions.

Australian Entity

The definition of an ***Australian entity*** in the PPSA can be summarised as:

- an individual who is located in Australia; and

Relevantly, the definition of an "Australian entity" in the PPSA includes a company registered under the Corporations Act;[30] and.[114]

- a corporation sole established under an Australian law; and
- a public authority or agency or instrumentality of the crown in right of Australia, or an Australian state or territory; and
- a registrable Australian body under the *Corporations Act* (in summary an Australian body corporate or unincorporated body which is none of the above).

Location

The rules in relation to the location of entities and property provide that, relevantly:

- a body corporate is located in the jurisdiction in which it is incorporated; and
- a body politic is located in the jurisdiction of the body politic;
- an individual is located at the individual's principal place of residence; and

needed for the PPSA to apply, rather than specifying examples of when it does apply. Examples of this can be found in the Explanatory Memorandum for the PPSA Bill and its second reading speech. Also, this approach is consistent with the legislative principle that some connection (which could be remote, or general) between the subject matter of the legislation and the jurisdiction of legislation is needed for legislation to be valid and the presumption of statutory interpretation that legislation is not intended to have an extra-territorial effect unless a contrary intention is expressed.

[30] For this purpose, this should include foreign companies which are registered under the *Corporations Act*.

[114] For this purpose, this should include foreign companies which are registered under the Corporations Act.

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- personal property (including an investment instrument and a negotiable instrument) is located in the particular jurisdiction in which the personal property is situated.[115]

However, there are some additional rules including, relevantly:(i) an investment instrument that is not evidenced by a certificate is located in the jurisdiction the law of which governs the transfer of the investment instrument; and

(ii) a negotiable instrument that is evidenced by an electronic record is located in the jurisdiction the law of which governs the negotiable instrument.

2.6 Jurisdictional scope of this memorandum

This memorandum is given on the assumption that the PPSA applies on a jurisdictional basis. For example, this memorandum does not address security interests granted by an entity which is not an Australian entity in:

- intermediated securities held with an intermediary that is located outside of Australia;
- financial property which is located outside of Australia;
- accounts which are payable outside of Australia; or
- intangible property (other than accounts) which is not created, arises or provided for by a law of Australia.

It is still possible that the general law of Australia can still apply to these interests, if Australian conflict of law rules so determine. However, registration requirements under, and other provisions of, the PPSA would not apply.

[115] We note for completeness that there are additional rules including in relation to certain collateral classes.

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3 Summary of the relevant requirements for the protection of enforcement of security under the *Netting Act*

3.1 Overview of the application of *Netting Act* to security-based collateral arrangements

In 2016, the *Financial System Legislation Amendment (Resilience and Collateral Protection) Act 2016* (Cth) ("***Collateral Protection Act***") and *Financial System Legislation Amendment (Resilience and Collateral Protection) Regulation 2016* (Cth) ("***Collateral Protection Regulation***") significantly altered the way in which Australian laws related to security, finance and insolvency apply in a financial market context.

Importantly, the *Collateral Protection Act* amended the *Netting Act* to facilitate the enforcement of particular forms of security. The amendments made to the *Netting Act* and other Acts by the *Collateral Protection Act* also clarified the manner in which close-out rights could be exercised and security could be enforced on the occurrence of specified resolution matters. However, like the current protections which the *Netting Act* provides to close-out netting, the new protections are subject to requirements (also described in this memorandum as safeguards) which must be satisfied in order for the *Netting Act* to protect the enforcement of security.

Some of the most relevant considerations as to the scope of the relevant amendments to the *Netting Act*, and implications on a Covered Base Agreements and CDAs, are set out below.

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SCHEDULE 3

SUMMARY OF THE RELEVANT REQUIREMENTS FOR THE PROTECTION OF ENFORCEMENT OF SECURITY UNDER THE NETTING ACT

0 3.2Scope of application

The amendments to sections of the Netting Act commenced on 1 June 2016. The amendments that are referred to in this memorandum Schedule apply in relation to:

(a) close-out netting contracts entered into after 1 June 2016, or that were in existence immediately before 1 June 2016;

(b) the enforcement of a security after 1 June 2016, even if the security was given before 1 June 2016;

(c) "trigger events" (as defined in the Collateral Protection Act) that occur for a close-out netting contract after 1 June 2016;[116] and

(d) a partial transfer if the certificate of transfer comes into force after 1 June 2016.

Most of these amendments do not apply in relation to an external administration that commenced before 1 June 2016. Accordingly, this current form of our memorandum opinion does not apply if there is an external administration that commenced before this date.

The amendments to the *Netting Act* have significant implications for the enforcement of security under security-based credit support arrangements which are entered into in respect of obligations of a party to a close-out netting contract (as defined in the *Netting Act*). As noted in paragraph B.2.6, provided

[116] A "trigger event" for a close-out netting contract is defined in the Netting Act to mean an event of a kind mentioned in paragraph (a) of the definition of close-out netting contract. Paragraph (a) of that definition provides that "a contract under which, if a particular event happens: (i) particular obligations of the parties terminate or may be terminated; and (ii) the termination values of the obligations are calculated or may be calculated; and (iii) the termination values are netted, or may be netted, so that only a net cash amount (whether in Australian currency or some other currency) is payable". Simply, a trigger event is an event which gives rise to a close-out right under the relevant close-out netting contract.

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that our interpretation of the Futures Liquidation Rights, Futures Netting Rights, Cleared Derivatives Liquidation Rights and Cleared Derivatives Netting Rights under their governing law, on the bases set out in paragraph B.2.6, is correct then the Covered Base Agreement and CDA should be a close-out netting contract for the purpose of the *Netting Act*.

1 3.3Protection of enforcement of security

The protection provided by the amended Netting Act to the enforcement of security is contained in section 14 of the Netting Act. That protection is provided in two sections, 14(1) and 14(2). The circumstances in which each section applies are different. For the reasons set out in Schedule 3 to this memorandum,[32] we will focus on section 14(2).

Section 14(1) of the Netting Act applies only if, relevantly, Australian law governs the 'close-out netting contract'. Accordingly, we do not consider section 14(1) further in this opinion.

Section 14(2) applies if a person who is, or who has been, a party to a close-out netting contract goes into "external administration"[33][117] and:

(a) Australian law governs the close-out netting contract; or

(b) Australian law governs the external administration.

Please see paragraphs B.2.6 above and C.I.3.8 paragraph 2.6 below and Schedule 3 for further consideration of the application of section 14(2) of the Netting Act.

[32] In summary, this is because we are asked to assume that the Covered Base Agreements and CDAs are not governed by an Australian law.

[33][117] Please refer to footnote 11 in relation to see paragraph 3 of Schedule 1 regarding the definition of "external administration." " in the Netting Act.

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Section 14(2)(fa) of the Netting Act, as amended, provides that:

> "security given over financial property, in respect of obligations of a party to the [close-out netting] contract, may be enforced in accordance with the terms of the security, provided the terms of the security are evidenced in writing (but see section 14A);"

This section is designed to protect the enforcement of security given over financial property, in respect of obligations of a party to the close-out netting contract in accordance with the terms of the security, provided the terms of the security are evidenced in writing. The requirement that the terms of the security are evidenced in writing is considered in paragraph ~~C.I.3.4~~ 2.2 below~~,~~ and the meaning of "financial property" is considered in paragraph ~~C.I.3.5~~ 2.3 below.

The 2016 Explanatory Memorandum provides that the reference to "security" in these sections contemplates the traditional forms of security, being the charge, mortgage, pledge and lien and analogous concepts under foreign law rather than non-traditional forms of "security interest" (as contemplated by the PPSA) such as a conditional sale agreement (including an agreement to sell subject to retention of title).~~34~~118

The enforcement of security which is protected under the Netting Act is not to be void or voidable in the external administration.

Relevantly, the protection of the enforcement of security (including the protection against the enforcement being void or voidable) applies despite:

- (i) the creation of any encumbrance, or any other interest, in relation to the financial property secured; or
- (ii) the operation of any encumbrance, or any other interest, in relation to that financial property, in contravention of a prohibition in the contract or in the protected security.~~35~~119

~~34~~118 2016 Explanatory Memorandum, [1.105].

~~35~~119 Section 14(2)(h) of the Netting Act.

These protections apply despite any other law (including the "specified provisions"), but subject to applicable "specified stay provisions". The effect of this is considered further in our responses set out in paragraph C.IV.16 below3.2 of Part G.

Importantly, the protections apply to the enforcement of security over financial property, in respect of obligations of a party to a close-out netting contract, only to the extent that certain safeguards are satisfied. These safeguards are considered in paragraphs C.I.3.4 2.2 to C.I.3.7 2.5 below. There are also specific limitations on these protections which are considered in paragraphs C2.6 I.3.8 to C.I.3.9 and 2.7 below.

1.2 3.4Terms of the security evidenced in writing

In order for the enforcement of security to be protected under the amended Netting Act, the terms of the security must be evidenced in writing. This requirement would be satisfied where a security arises through an act where the terms of an agreement in writing between the parties provide for the security to arise on the performance or occurrence of such an act.[36]120

1.3 3.5Financial property

To have the benefit of the protections available under the Netting Act, the property over which security is granted must be "financial property". The "financial property" concept is intended to cover property which is commonly provided as collateral in financial markets transactions.[37]121

Based on the assumptions which we have been asked to make for the purposes of this opinion, the Covered Collateral should fall within the definition of financial property in the Netting Act. However, it is a question of fact whether any particular Covered Collateral would indeed constitute financial property.

For these purposes, financial property is any of the following property:

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[36]120 2016 Explanatory Memorandum, [1.106].

[37]121 2016 Explanatory Memorandum, [1.117].

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(a) a security;[38][122]

(b) a derivative;[123]

(c) a financial product that is traded on a financial market that is:

(i) operated in accordance with an Australian market licence; or

(ii) exempt from the operation of Part 7.2 of the Corporations Act;[39][124]

(d) a negotiable instrument;[40][125]

(e) currency (whether of Australia or of any other country);

(f) gold, silver or platinum;

(g) property declared by the regulations to be financial property for the purposes of the Netting Act[;], which includes cash collateral (including cash, certificates of deposit and bank bills);[126]

(h) "intermediated financial property"[-], being[,] the rights of a person in whose name an intermediary maintains an account to which interests in property or rights to payment or delivery of property of a kind mentioned in any of paragraphs (a) to (g) may be credited or debited, to the extent that those rights relate to the interests in that property or the rights to payment or delivery of that property;

(i) a document evidencing ownership of gold, silver or platinum;

(j) cash collateral (including cash, certificates of deposit and bank bills);

[38][122] The term "security" has the meaning given in section 92 of the Corporations Act (but, for this purpose, sections 92(3)92(2A), (3) and (4) of the Corporations Act are to be disregarded).

[123] The term "derivative" in the Netting Act has the same meaning as in Chapter 7 of the Corporations Act.

[39][124] The terms "financial product", "financial market" and "Australian market licence" have the meanings given in the Corporations Act.

[40][125] The term "negotiable instrument" has the meaning given in the PPSA.

[126] Regulation 5(2)(b) of the Netting Regulations.

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(k) property described in paragraph 5(b), (c) or (e), or paragraph 25, of Attachment H to Prudential Standard APS 112 — Capital Adequacy: Standardised Approach to Credit Risk, made by the APRA under section 11AF of the *Banking Act* and as in force from time to time, as property that may be recognised as eligible collateral (ignoring any conditions set out in that Attachment H);[41]

(l) property described in paragraph 5(d) of Attachment H to that prudential standard, ignoring:

(i) the words "and the ADI holding the security has no information suggesting that the security justifies a rating below this level"; and

(ii) any conditions set out in the Attachment;

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[41] Those paragraphs of the APRA standard are:

5.(b) gold bullion;

5.(c) subject to paragraph 11 of this Attachment, debt securities rated by an [external credit assessment institution ("**ECAI**")] where these debt securities have a credit rating grade of either:

(i) four (or better) for long-term securities issued by: Commonwealth, State and Territory governments in Australia (including State and Territory central borrowing authorities); central, state and regional governments in other countries; the Reserve Bank of Australia; central banks in other countries; and the international banking agencies and multilateral regional development banks that qualify for a zero per cent risk-weight as detailed in Attachment A; or

(ii) three (or better) for short-term or long-term securities issued by ADIs, overseas banks, Australian and international local governments and corporates;

5.(e) subject to paragraph 11 of this Attachment, units in a listed trust where the unit price of the trust is publicly quoted on a daily basis and the listed trust is limited to investing in the instruments detailed in paragraphs 5(a) to 5(d) of this Attachment [footnote omitted];…

11. Collateral in the form of securities issued by the counterparty to the credit exposure (or by any person or entity related or associated with the counterparty) is considered to have a material positive correlation with the credit quality of the original counterparty and is therefore not eligible collateral.

25. …the following forms of collateral are eligible collateral under the comprehensive approach:

(a) equities (including convertible bonds) that are included in a main index or listed on a recognised exchange;

(b) units in listed trusts that invest in equities as set out in paragraph 25(a) of this Attachment.

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(m) a covered bond;[42] and

(i) (n)proceeds (including rights and property) of property that is financial property.

The property described in paragraphs (a) to (ni) above will constitute financial property regardless of whether the property (or, for paragraph (h), the intermediary or the account) is in Australia or elsewhere.

Although property can be excluded from the definition of "financial property" for the purposes of the Netting Act through declaration in the regulations, as at the date of this memorandum opinion there is no such declaration in the regulations.

1.4 3.6Eligible obligations

The protection provided to the enforcement of security under the Netting Act applies to the enforcement of security over financial property, in respect of obligations of a party to a close-out netting contract, only to the extent that, the obligations secured by the financial property, and discharged through the enforcement, are:

(a) eligible obligations in relation to the contract;or

(b) obligations under the contract of a party to the contract to pay interest on an eligible obligation; or

(c) obligations of a party to the close-out netting contract to pay costs and expenses incurred in connection with enforcing security given in respect of an eligible obligation.

For these purposes, an obligation is an "eligible obligation" in relation to a close-out netting contract if the obligation is any of the following:

[42] The term "covered bond" has the meaning given in the *Banking Act*.

(i) ~~(i)~~an obligation under the contract of a party to the contract that relates to a derivative~~43~~127 or foreign exchange contract~~44~~128 or is of another prescribed kind;~~45~~129

(ii) ~~(ii)~~an obligation that results from the netting of ~~two~~ 2 or more obligations that are created under the contract that:

() ~~(A)~~must include at least one obligation covered by paragraph (i) immediately above; and

(A) ~~(B)~~may include one or more incidental obligations that, taken together, do not form a material part of the net obligation; or

(iii) ~~(iii)~~an obligation declared by the regulations to be an eligible obligation in relation to a close-out netting contract.~~46~~130

However, ~~for the purposes of this memorandum,~~ the Netting Regulations provide that none of the following are eligible obligations in relation to a close-out netting contract:

() ~~(A)~~an obligation under a credit facility,~~47~~131 including:

(i) a margin lending facility;~~48~~132 and

(ii) an obligation under a financial product that is declared by the ~~Australian Securities and Investments Commission~~ ASIC under section 761EA(9) of the Corporations Act not to be a margin lending facility;

~~43~~127 The term "derivative" in the Netting Act has the same meaning as in Chapter 7 of the Corporations Act.

~~44~~128 The term "foreign exchange contract" has the same meaning as in Chapter 7 of the Corporations Act.

~~45~~129 In this regard, the ~~*Payment Systems and*~~ Netting Regulations ~~*2001* (Cth) ("**Netting Regulations**")~~ prescribe as an eligible obligation an obligation that relates to an arrangement that is a forward, swap or option, or any combination of those things, in relation to one or more commodities.

~~46~~130 As at the date of this ~~memorandum~~opinion, no such declaration has been made.

~~47~~131 This term has the meaning given in the regulations made for the purposes of subparagraph 765A(1)(h)(i) of the Corporations Act.

~~48~~132 The term "margin lending facility" has the same meaning as in Chapter 7 of the Corporations Act.

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() (B)an obligation under a deposit-taking facility; and

(A) (C)an obligation under a reciprocal purchase agreement (otherwise known as a repurchase agreement), a sell-buyback arrangement or securities loan arrangement.[49][133]

In light of paragraph (C) above, Buy/Sell-Back Transactions, Repurchase Transactions and Securities Lending Transactions, as described in Appendix A, should not be executed, carried or cleared under a Covered Base Agreement and CDA if the Clearing Member wishes to rely on the protection given to the enforcement of security under the *Netting Act* where the obligations discharged through the enforcement include eligible obligations that relate to those types of transactions.

Whilst the amendments to the Netting Act in 2016 to protect the enforcement of security considered in this Part Schedule were made to ensure that entities subject to Australian Law can enforce rights in margin provided by way of security in the manner contemplated by the margin requirements for non-centrally cleared derivatives, the effect of those amendments is not confined to the enforcement of security to discharge obligations that relate only to non-centrally cleared derivatives.

As noted above, one of the circumstances in which an obligation is an 'eligible obligation' in relation to a close-out netting contract is if the obligation is an obligation under the contract of a party to the contract that relates to a derivative or foreign exchange contract. The meanings given to the terms 'eligible obligation' and 'derivative' do not distinguish between obligations that relate to cleared derivatives and uncleared derivatives. Indeed, the 2016 Explanatory Memorandum acknowledged the flexibility and breadth of the definition of derivative, stating that:

[49][133] Under the Netting Regulations, each of the following obligations have also been declared not to be an eligible obligation: an obligation under a contract of insurance, including a life policy or a sinking fund policy within the meaning of the Life Insurance Act; an obligation under a managed investment scheme (within the meaning of the Corporations Act); an obligation under a lease or licence; an obligation under a guarantee; an obligation to pay money under a cheque, an order for the payment of money or a bill of exchange.

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> *The key consideration inherent in the term eligible obligation is whether an obligation under the contract of a party to the contract relates to a derivative or foreign exchange contract or is of another prescribed kind. The definition of derivative from Chapter 7 of the Corporations Act has been used here due to its flexibility and breadth…*~~50~~*134*

In our view, the term 'eligible obligations' includes obligations that relate to cleared derivatives that otherwise fall within the scope of that term.

1.5 ~~3.7~~Possession or control ~~of the Clearing Member~~

The protection provided to the enforcement of security under the Netting Act only applies to the extent that, before the enforcement, the financial property is transferred or otherwise dealt with so as to be in the possession or under the control of the secured person, or another person (who is not the grantor) on behalf of the secured person under the terms of an arrangement evidenced in writing. The 2016 Explanatory Memorandum expressly recognised Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements ("**EU Directive**") and *The Financial Collateral Arrangements (No 2) Regulations 2003* (UK)~~51~~135 ("**FCA Regulations**"), and associated commentary by industry associations such as the Financial Markets Law Committee. The EU Directive and FCA Regulations were informative in the development of the Australian approach.~~52~~136

There are specific circumstances for the purposes of the Netting Act in which possession and control will *not* exist, and also those in which possession and control will exist~~. This memorandum also provides clarification on the impact of a Covered Customer having specific rights which are commonly found in financial market transactions on the Clearing Member having possession or control of the~~

~~50~~134 2016 Explanatory Memorandum, [1.139].

~~51~~135 As amended by *The Financial Collateral Arrangements (No 2) Regulations 2003 (Amendment) Regulations 2009* (UK) and *The Financial Markets and Insolvency (Settlement Finality and Financial Collateral Arrangements) (Amendment) Regulations 2010* (UK).

~~52~~136 2016 Explanatory Memorandum, [1.145].

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relevant financial property.[53] Please see paragraph C.II.5.1 for more detail in relation to the concepts of possession and control for the purposes of the *Netting Act*., some of which are considered below.[137]

3.8 Circumstances affecting the protection

If security is given over financial property, in respect of obligations to a party to a Covered Base Agreement or CDA, then there are some limitations on the protections afforded to the enforcement of the security under the *Netting Act*. These limitations apply in relation to rights and obligations under the Covered Base Agreements and CDAs in the same way as they apply in relation to rights and obligations under the Covered Base Agreement and CDA and described in paragraph B.2.6 and paragraph 6 of Schedule 3.[54]

[53] The *2016 Explanatory Memorandum* acknowledged that "historical legal concepts of possession and control may need to, but do not currently (or adequately), deal with control structures used in modern financial market[s] and therefore the Bill provides certainty as to specific circumstances in which the control test in paragraph 14A(1)(b) will, and will not, be satisfied. These deeming provisions are intended to be inclusive and are not intended to restrict in any way the general application of the concepts of possession or control to financial market structures": [1.151].

[137] The 2016 Explanatory Memorandum acknowledged that "historical legal concepts of possession and control may need to, but do not currently (or adequately), deal with control structures used in modern financial market[s] and therefore the Bill provides certainty as to specific circumstances in which the control test in paragraph 14A(1)(b) will, and will not, be satisfied. These deeming provisions are intended to be inclusive and are not intended to restrict in any way the general application of the concepts of possession or control to financial market structures": [1.151] (footnote omitted).

[54] Section 14(9) of the *Netting Act*.

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3.9 Manner of enforcement to comply with applicable law

The *Netting Act* protection of enforcement of security only applies to the extent that the enforcement of security is carried out in a manner that complies with section 420A of the *Corporations Act* (if it applies) and any applicable general law duties that are not inconsistent with the terms of the security.[55] Some of these duties are considered in paragraph C.III.11 of this memorandum below. The *2016 Explanatory Memorandum* also provides that:

> "Whilst the security may be enforced in accordance with the terms of the security, the protections provided to the enforcement of security under sections 14(1) and 14(2) would not apply to the extent the terms of the security purported to allow a secured person to appropriate or sell financial property at zero, or nominal, value as the enforcement would not reflect any attempt to calculate, or value, the financial property in good faith or in a commercially reasonable manner."[56]

The *2016 Explanatory Memorandum* provides that the reforms to the *Netting Act* which protect the enforcement of security in accordance with the *Netting Act* (including the provisions relating to possession and control) should not be interpreted as limiting or otherwise restricting anything which would otherwise be available or protected at law (including any rights which a secured party would otherwise have by virtue of the PPSA, the exercise of those rights and any protection which applies to those rights or the exercise of those rights).[57]

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[55] *2016 Explanatory Memorandum*, [1.159], which also states that, for example, "the duties to which controllers are subject under Part 5.2 of the *Corporations Act* (e.g. section 420A regarding the controller's duty of care in exercising power of sale) may still apply". See also *2016 Explanatory Memorandum*, [1.168] - [1.169] which states:

> [I]f another law purported to prevent enforcement of the security in accordance with its terms, it would be inconsistent and must yield. Similarly, if any other law purported to impose conditions that must be satisfied before the security can be enforced, that other law would also be inconsistent and must yield…
>
> However, another law which purported to regulate the manner in which the security is enforced (for example, section 420A of the *Corporations Act*, if it applied, as described above) would continue to apply provided that it only impacted the way in which the secured person need to enforce its security and did not in any way inhibit the actual enforcement of security.

[56] *2016 Explanatory Memorandum*, [1.160].

[57] *2016 Explanatory Memorandum*, [1.109].

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II. VALIDITY OF SECURITY INTERESTS

We set out below our analysis of the issues raised under the heading "Validity of Security Interests" in Part III of the Instruction Letter. Except and to the extent as noted in each response, our response to the questions in this part applies equally in circumstances where the *Netting Act* protection for the enforcement of security is sought to be relied on and in circumstances where it is not.

1 Law governing contractual and validity aspects of security

Under the laws of Australia, what law governs the contractual aspects of a security interest in the various forms of Eligible Collateral under the Covered Base Agreement and CDA? Would the courts of Australia recognise the validity of a security interest created under each Covered Base Agreement and CDA, assuming it is valid under the governing law of such Covered Base Agreement and CDA?

The *Netting Act* does not contain rules to determine the law governing the contractual aspects and, consequently, we do not consider there is any inconsistency between that Act and the application of the PPSA in this regard. Accordingly, our answer to this question applies in the same way, irrespective of whether the *Netting Act* applies to protect the enforcement of a security.

1.1 The laws governing the contractual aspects of a security interest

Under general Australian Law, the law governing the contractual aspects of a security interest granted by an Australian Company in the various forms of Eligible Collateral identified is the governing law of the relevant Covered Base Agreement and CDA, being New York law. The 'governing law' provisions of the PPSA (described in paragraph 1.2 immediately below) expressly state that those provisions do not affect the law that governs contractual obligations (including any obligations arising under a security agreement).

1.2 The laws governing validity

The *Netting Act* does not contain rules to determine the law governing the validity of security interests and, consequently, we do not consider there is any inconsistency between that Act and the application of the PPSA in this regard. Accordingly, our answer to this question applies in the same way, irrespective of whether the *Netting Act* applies to protect the enforcement of a security.

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In addition to the provisions which define the jurisdictional reach (described in paragraph C.I.2.6), the PPSA contains provisions which set out which law, in proceedings in an Australian court, governs the validity of security interests to which the PPSA applies.[58] These 'governing law' provisions apply only to interests that arise on or after 30 January 2012, being the date on which the PPSA commenced operation.

The 'governing law' provisions provide a primary rule, and then secondary rules applicable to different types of personal property if the primary rule does not apply. The effect of these rules is that:

(a) ***(primary rule)*** Australian law will govern the validity of the security interest in certain circumstances if the security agreement expressly provides that Australian Law governs the security interest. This primary rule will not apply to the Covered Base Agreements and CDAs given they are governed by New York law; and

(b) ***(secondary rules)*** if the primary rule described in paragraph (a) above does not apply, then if the security interest is in:

- ***negotiable instruments and investment instruments***, Australian law will govern the validity of the security interest if the security interest has attached under Australian Law and, if at the time of the attachment, the property was located in Australia and the secured party had sufficient possession or control to perfect the security interest. Otherwise, the validity of the security interest is governed by the law of the jurisdiction in which the grantor is located when the security interest attaches;[59] and

[58] There are limited separate provisions dealing with the jurisdictional linkage required for the operation of the enforcement provisions in the PPSA and for priorities of security interests in property which has been relocated to Australia. We do not comment on those in this memorandum.

[59] The PPSA does not expressly deal with the consequences if the foreign law has no concept of attachment.

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- ***an account or intangible property***, the validity of the security interest is governed by the law of the jurisdiction in which the grantor is located when the security interest attaches, under that law, to the property.

The time of attachment is considered in paragraph C.II.5.3 below.

No secondary rules on the governing law applicable to the validity of a security interest in intermediated securities are contained in the PPSA.[60] There are two possible consequences of this:

- the PPSA automatically applies in respect of the validity of a security interest in intermediated securities if the jurisdictional provisions of the PPSA are satisfied (that is, that the intermediary is located in Australia) (see paragraph C.I.2.5 above for further detail); or
- the general law of Australia operates to determine the validity of a security interest in intermediated securities.

In our opinion, the better view is that the lack of secondary rules in relation to intermediated securities is not intended to mean that the PPSA always governs the validity of a security interest in intermediated securities. Rather, the jurisdictional provisions are intended to specify when the 'governing law' provisions of the PPSA apply. Given that no express rules on the governing law applicable to the validity of a security interest in intermediated securities are contained in the PPSA, and in the absence of any other legislation determining the law governing the validity of a security interest, the general Australian Law should determine the governing law.[61]

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[60] No explanation for this is given in the Explanatory Memorandum to the *Personal Property Securities Bill 2009* (Cth) ("**PPS Bill**"). Initial drafts of the PPS Bill did include provisions applicable to intermediated securities included which were based on The Hague Conference Convention of 5 July 2006 on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary, which Australia has not signed.

[61] The PPSA expressly does not repeal the common law, including in relation to choice of law rules, to the extent that it is capable of operating concurrently with the PPSA. This interpretation is consistent with the statement in Paragraph 7.2 of the Explanatory Memorandum for the PPS Bill that:

> "As there are connecting factors which must be met before Australian law is able to determine which law governs a security agreement, Part 7.2 should be read together with clause 6, Connection with Australia."

The alternative view would be that the absence of governing law rules in Part 7.2 of the PPSA in relation to a security interest in intermediated securities was intended to result in the validity and perfection requirements in the PPSA applying to all intermediated

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Under general Australian Law, assuming that the choice of law in the relevant Covered Base Agreement and CDA is a valid and proper choice of law (see paragraph C.V.18), the Australian Courts would recognise the validity of a security interest created under the Covered Base Agreement and CDA if the security interest was valid under the governing law of the Covered Base Agreement and CDA.

In addition to the rules above, the 'governing law' provisions of the PPSA provide that the laws of the jurisdiction which govern the validity of the security interest in collateral also apply to the validity of the security interest in proceeds of that collateral.[62]

2 Law governing perfection of security interest

Under the laws of Australia, what law governs the proprietary aspects of a security interest (that is, the formalities required to protect a security interest in Eligible Collateral against competing claims) granted by the Covered Customer under each Covered Base Agreement and CDA (for example, the law of the jurisdiction of incorporation or organisation of the Covered Customer, the jurisdiction where the Eligible Collateral is located, or the jurisdiction of the location of the the CClearing Member or DCO's Intermediary in relation to Eligible Collateral in the form of indirectly held securities)? What

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securities to which the PPSA applies – being those granted by an Australian entity or where the intermediary is located in Australia (see paragraph C.II.1.2). However, there is no indication that the omission of an express reference to intermediated securities from the governing law rules in the PPSA was intended to produce this result. Taking into account that such a result would have been a significant departure from previously applicable general law principles, and is not mentioned in the explanatory memorandum which accompanied the PPSA, this intention seems unlikely. Also, if this were intended, then it would have been easily achieved by the inclusion of intermediated securities in the rules applying to financial property, such as investment instruments. As noted above, these rules focus on the location of grantors (which is different to whether they are Australian entities as it excludes foreign incorporated companies), the time of attachment and perfection and potentially the location of the property at those times. The implication that the absence of any reference to intermediated securities in Part 7.2 was intended to result in a much less sophisticated rule applying to intermediated securities (which makes no reference to whether the grantor is "located" in Australia) is somewhat difficult to support. Instead, we consider that the intention was for the PPSA to not affect the general law rules on location of property which previously applied to intermediated securities. This is consistent with the absence of any reference to intermediated securities in Part 7.2. Also, it makes sense from a policy perspective if the new rules on intermediated securities evidenced in earlier PPSA drafts were not able to be included until Australia signed the Hague Convention on intermediated securities (referred to in footnote 50 above).

[62] Unless the proceeds are an account (unless the account arises from the dealing which gave rise to the proceeds).

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factors would be relevant to this question? Where the location (or deemed location) of the Eligible Collateral is the determining factor, please briefly describe the principles governing such determination under Australian Law with respect to the different types of Eligible Collateral. In particular, please describe how the laws of Australia apply to each form in which securities Eligible Collateral may be held as described in assumption (b) in section 1, Part B of Schedule 1 to this memorandum.

The *Netting Act* does not contain rules to determine the law governing the perfection and effect of perfection or non-perfection of security interests and, consequently, we do not consider there is any inconsistency between that Act and the application of the PPSA in this regard. Accordingly, our answer below applies equally irrespective of whether the *Netting Act* applies to protect the enforcement of a security. However, see our comments in respect of the relevance of perfection to the extent that the *Netting Act* applies to the enforcement of security in paragraph C.II.5.1 below.

Subject to the following, the 'governing law' provisions described in paragraph C.II.1.2 above apply under Australian Law in the same way to determining the law governing perfection and effect of perfection or non-perfection of security interests as they do to determining the law governing the validity of the security interest.

The secondary rules that apply to determine the law governing the validity of the security interest if the security interest is in financial property or intangible property are determined by reference to the time when the security interest attached. Likewise, the secondary rules that apply to determine the law governing the perfection and effect of perfection or non-perfection of security interests in those classes of property at a particular time are determined as of that time.

Also there are no secondary rules on the governing law applicable to the perfection and effect of perfection or non-perfection of a security interest in intermediated securities. For the reasons set out in paragraph C.II.1.2 above, in our opinion, the better view is that, in the absence of any other legislation determining the law governing the validity of a security interest, the general Australian Law will determine the governing law.

Under the general Australian Law (particularly rules of private international law and conflicts of laws), the better view is that the relevant law governing the perfection and effect of perfection or non-perfection of a security interest in a chose in action is the law of the place of its location (lex situs).

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Generally, the situs of a chose in action is the place where it is properly recoverable or may be enforced.[63] However, this rule is not easily applied in the context of beneficial co-ownership interests held by an intermediary. Although Australian Law is not entirely clear on this issue, the most likely outcome is that the governing law is the law of the place where the intermediary is located (referred to as the *place of the relevant intermediary approach* ("**PRIMA**")).[64] If there is a chain of intermediaries, each of which holds securities in an omnibus holding for another intermediary down the chain, then the relevant intermediary for determining PRIMA is the last one in the chain (i.e. the one that credits the interest in the securities to an account in the name of the grantor). In Australia, and as a matter of Australian Law, an intermediary generally holds securities as trustee for the person in whose name the securities account is maintained (referred to in this section of our memorandum as the "**account holder**"). The interests of the account holder are generally characterised as a right to a beneficial interest in whatever is held by the intermediary for the account holder (whether it holds the securities directly or indirectly with another intermediary).[65] Where the intermediary holds interests in securities in an omnibus account for all their clients, then the account holder's interest under Australian Law is generally characterised as a right to a beneficial co-ownership interest in the pool of assets held by the intermediary.[66]

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[63] *Dicey, Morris and Collins on The Conflict of Laws*, 14th Edition, p 1125.

[64] The Hague Conference Convention of 5 July 2006 on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary, which Australia has not signed, recognised PRIMA.

[65] In addition to the beneficial interests referred to above, the rights of the account holder may also comprise contractual rights against the intermediary (including, for example, to demand that the security be withdrawn from the securities account). The precise nature of the rights of the holder of the account in respect of indirectly held securities will be determined, among other things, by the law of the agreement between the holder and the intermediary relating to the account and the law generally applicable to the intermediary. Of course, the interest might be characterised differently in a foreign jurisdiction, if applicable pursuant to the choice of law rules of that foreign jurisdiction.

[66] The following principles support this approach:

(a) if it is true that the nature of the interest is a beneficial co-ownership interest in the pool of assets held by the intermediary, then to determine the location of such a beneficial interest, an Australian Court would apply either the place where the trust assets are located or the place of the trustee. If the beneficiary has an absolute right to call for the delivery of the trust assets in specie, then the beneficial interest will be located at the place of the assets. If the beneficiary does not have such a right, then the location of the interest will be the place of the trustee: *Dicey, Morris and Collins on The Conflict of Laws*, 14th Edition, p 1127. In the case of intermediated book entry securities (such as all those in Austraclear, Euroclear or Clearstream), an investor does not have a right to demand a transfer in specie, but only has a right to call for delivery of equivalent securities.

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In addition to the rules above, the laws of the jurisdiction which govern the perfection and the effect of perfection or non-perfection of a security interest in collateral also apply to the perfection and effect of perfection or non-perfection of that security interest in the proceeds of that collateral (respectively).

3 Recognition of security interest

Would the courts of Australia recognise a security interest in each type of Eligible Collateral created under each Covered Base Agreement and CDA? In answering this question, please bear in mind the different forms in which securities Collateral may be held, as described in assumption (b) in section 1, Part B of Schedule 1 to this memorandum. Please indicate, in relation to cash Collateral, if your answer depends on the location of the account in which the relevant obligations are recorded and/or upon the currency of those obligations.

In our opinion, irrespective of whether the *Netting Act* applies to protect the enforcement of a security, Australian Courts would recognise a security interest in each type of Eligible Collateral created under each Covered Base Agreement and CDA, provided that:

(a) the security interest was valid under the laws that govern the validity of the security interest (as to which see paragraph C.II.1.2 above); and

(b) unless the *Netting Act* applies to protect the enforcement of security, any perfection requirements in relation to the Eligible Collateral had been complied with under the laws that

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Accordingly, under the application of traditional conflict of law principles, the lex situs should be the place of the intermediary: Moshinsky M; "Securities held through a securities custodian - conflict of laws issues" (1998) *JIBFL* 18;

(b) the principle traditionally applied to determine the (fictional) location of intangibles is that they are located where they may be enforced. It has been argued that this is essentially a question of locating the place where the record that determines the interest is located; and

(c) the alternative approach, being the look-through approach would not produce a result which is consistent with the PPSA framework. This would result in the governing law being determined by the location of the underlying instruments which the intermediated security represents. However, this is a different kind of property under the PPSA, being investment instruments, which have their own choice of law rules. Although it would be possible to argue, it seems highly improbable that the governing law rules for intermediated securities should be determined by reference to the common law rules applicable to investment instruments which are otherwise inapplicable because of the PPSA.

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govern the perfection and effect of perfection or non-perfection of the security interest (as to which see paragraph C.II.2 above).

Prior to the commencement of the PPSA there had been some uncertainty under Australian Law as to whether a person may take a security interest in respect of their own indebtedness. The PPSA clarifies that it is possible for a person who owes an obligation to another person to take a security interest over the other person's right to that performance, dispelling concerns with the effectiveness of "charge-backs" in Australia. The amended *Netting Act* also clarifies that it is possible for a person who owes payment or performance of an obligation to another person to take security over the other person's right to require the payment or performance of the obligation.

4 Effect of fluctuating exposures or Eligible Collateral

What is the effect, if any, under the laws of Australia of the fact that the amount secured or the amount of Eligible Collateral subject to the security interest will fluctuate under the Covered Base Agreement and CDA (including as a result of entering into additional Covered Transactions from time to time)? In particular:

(a) *would the security interest be valid in relation to future obligations of the Covered Customer?*

(b) *would the security interest be valid in relation to future Collateral (that is, Eligible Collateral not yet delivered to the Clearing Member at the time of entry into the relevant Covered Base Agreement and CDA)?*

(c) *is there any difficulty with the concept of creating a security interest over a fluctuating pool of assets, for example, by reason of the impossibility of identifying in the Covered Base Agreement and CDA the specific assets transferred by way of security?*

(d) *is it necessary under the laws of Australia for the amount secured by each Covered Base Agreement and CDA to be a fixed amount or subject to a fixed maximum amount?*

(e) *is it permissible under the laws of Australia for the Clearing Member to hold Collateral in excess of its actual exposure to the Covered Customer under the related Covered Base Agreement and CDA?*

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In relation to (a), it is understood that the security interest in any specific Collateral would only be relevant in relation to future obligations, if ever, at the time such future obligations arise and then only in relation to Collateral held at that time. This question concerns whether it would be necessary for either party to perform any action at such time in order to ensure the effectiveness of the security interest as security for such obligations or whether the security interest would take effect in relation to those future obligations without further action by either party.

In relation to (b), it is understood that the security interest in Collateral to be delivered at some point in the future after the time of entry into the relevant Covered Base Agreement and CDA would not take effect in relation to such Collateral until the Collateral had been delivered to the Clearing Member in accordance with the Covered Base Agreement and CDA. This question concerns whether it would be necessary for either party to perform any action at such time in order to ensure the effectiveness of the security interest in relation to such Collateral or whether the security interest would take effect in relation to such Collateral without further action (other than the delivery) by either party.

In relation to (c), you may assume that each specific delivery to the Clearing Member and return by the Clearing Member of Collateral under the Covered Base Agreement and CDA from time to time would be properly recorded by the Clearing Member, so that, while the pool of Collateral would change from time to time, at any specific time the composition of the pool of Collateral could be clearly identified by the Clearing Member.

As a matter of Australian Law there are no adverse consequences arising from the fact that the amount secured or the amount of Eligible Collateral subject to the security interest will fluctuate under the Covered Base Agreement and CDA, provided it does so in accordance with the terms agreed between the parties. Other than as set out in paragraph 4(c) below, our answer applies equally irrespective of whether the *Netting Act* applies to protect the enforcement of the security.

Subject to the proviso above, and in answer to the specific questions on this point:

(a) *Future Obligations*

The security interest would be valid in relation to future obligations of the Covered Customer, provided the future obligations are able to be identified as and when they arise, by reference to the terms of the Covered Base Agreement and CDA. The PPSA provides that a security

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agreement may provide for future advances, and that a security interest provided for by a security agreement has the same priority in respect of all advances (including future advances) and obligations secured by the agreement.[67][68]

(b) *Future Collateral*

The security interest would be valid in relation to future Collateral, provided the future Collateral is able to be ascertained as and when it is provided as Collateral. The PPSA provides that a security agreement may provide for security interests in after-acquired property and that a security interest in after-acquired property attaches without specific appropriation by the grantor. As a matter of Australian Law, the security interest would not be created until the collateral is provided.

(c) *Fluctuating pool of assets*

There is no difficulty with the concept of creating a security interest over a fluctuating pool of assets, provided the pool of assets is identified with sufficient clarity to identify the collateral at any given time. However, in order for the *Netting Act* protection to apply to the enforcement of the security, a number of conditions need to be met, including that the Eligible Collateral must be transferred or otherwise dealt with before enforcement so as to be in the possession or under the control of the Clearing Member, or another person (who is not the Covered Customer) on behalf of the Clearing Member. For these purposes, this condition will not be satisfied if, under the security, the Covered Customer is free to deal with the Eligible Collateral in the ordinary course of business until the Clearing Member's interest in the Eligible Collateral

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[67] An "*advance*" is broadly defined to mean the payment of currency, the provision of credit or the giving of value and includes any liability of a debtor to pay interest, credit costs and other charges or costs payable by the debtor in connection with the advance or the enforcement of a security interest securing the advance. A "*future advance*" is defined broadly to mean an advance secured by a security interest (whether or not made pursuant to an obligation), if the advance is made after the security agreement was made or expenses in relation to the enforcement of a security interest that are secured by the security interest.

[68] Our conclusion is not altered by the fact that specific Covered Transactions to which the collateral relates will change over time as new Covered Transactions are entered into under a particular Covered Base Agreement or CDA and as Covered Transactions are cleared according to their terms.

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becomes fixed and enforceable. Please see our response set out in paragraph C.II.5.1 for more detail in this regard.

(d) *Necessity for Fixed Amount*

It is not necessary under Australian Law for the amount secured by the Covered Base Agreement and CDA to be a fixed amount or subject to a fixed maximum amount.

(e) *Excess Collateral*

It is permissible under Australian Law for the Clearing Member to hold Collateral in excess of its actual exposure to the Covered Customer under the related Covered Base Agreement and CDA.

In regards to the effect of the recent amendments to the *Netting Act* on the above, the *2016 Explanatory Memorandum* provides as follows:

> *The protections provided under this Bill provide a facilitative protective regime (subject to the safeguards set out in the Bill) and do not adversely affect existing Australian laws. For example, it is noted that under existing Australian law, security may be valid notwithstanding the fact that the security secures future obligations or fluctuating obligations, or that the security is granted over a fluctuating but identified and identifiable pool of property (provided it does so in accordance with the terms agreed between the parties), or that the grantor may provide financial property in excess of the secured obligations. Additionally, the Bill does not impose a requirement for the amount secured to be subject to a fixed amount or fixed maximum amount which does not otherwise exist under Australian law.*[69]

5 Steps for attachment and perfection

Assuming that the courts of Australia would recognise the security interest in each type of Eligible Collateral created under each Covered Base Agreement and CDA, is any action (filing, registration,

[69] *2016 Explanatory Memorandum*, [1.105].

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notification, stamping, notarisation or any other action or the obtaining of any governmental, judicial, regulatory or other order, consent or approval) required in Australia to perfect that security interest? If so, please indicate what actions must be taken and how such actions may differ depending on the type of Eligible Collateral in question.

As discussed in paragraph C.I.3.3 of this memorandum, the *Netting Act* protection of enforcement of security applies despite any other law (including the additional perfection requirements under the PPSA) but subject to certain safeguards being met (and any applicable specified stay provision). However, the steps for attachment and perfection under the PPSA continue to be relevant to an enforcement of security if the Covered Customer is not subject to external administration governed by an Australian law (as discussed in Part C.I of this memorandum). On this basis, our response to this question considers the requirements for enforceability of security interests against the grantor and third parties:

(a) under the Netting Act, in paragraph C.II.5.1 below, that the Eligible Collateral must be transferred or otherwise dealt with before enforcement so as to be in the possession or under the control of the Clearing Member, or another person (who is not the Covered Customer) on behalf of the Clearing Member;[70] and

(b) under the PPSA (which are relevant when the *Netting Act* protection does not apply but which we recommend compliance with) in paragraphs C.II.5.2 to C.II.5.4 below, being the requirements of attachment and perfection (which defines when the security interest sets its priority against other interests in the same collateral).

[70] We assume for these purposes that:

1 the enforcement of the security is within the scope of application of the *Netting Act* (as set out in paragraph C.I.3.2);

2 the *Netting Act* requirements considered in paragraphs C.I.3.4, C.I,3.5, C.I.3.6, and C.I.3.7 are met; and

3 that the limitations to the *Netting Act* protection considered in paragraph C.I.3.8 do not apply.

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4.1 Possession and control requirements under the *Netting Act*

As noted above, for the *Netting Act* protection to apply to the enforcement of security, a number of conditions need to be met, including that the Eligible Collateral must be, before enforcement, transferred or otherwise dealt with so as to be in the possession or under the control of the Clearing Member, or another person (who is not the Covered Customer) on behalf of the Clearing Member under the terms of an arrangement evidenced in writing. Whilst some aspects of the possession and control concepts are questions of law, it is also a question of fact as to whether Eligible Collateral has been transferred or otherwise dealt with so as to be in the possession or under the control of the Clearing Member or another person (who is not the Covered Customer) on behalf of the Clearing Member, under the terms of an arrangement evidenced in writing. To that end, there are specific circumstances in which possession and control will, and will *not*, exist for the purposes of the *Netting Act* as set out below (although these are not intended to be an exhaustive list).

Circumstances where the financial property is not in the possession or control of the Clearing Member FCM (or person acting on their behalf)

Financial property is taken to *not* be in the possession or control of a person if, under the security, the Covered Customer is free to deal with the financial property in the ordinary course of business[71][138] until the Clearing Member's FCM's interest in the financial property becomes fixed and enforceable.[72][139] This applies even if the Clearing Member's FCM's interest in the financial property becomes fixed and enforceable before the enforcement of the security over that property.[73][140]

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[71][138] The 2016 Explanatory Memorandum states that this concept reflects the "ordinary course of business" concept set out in *In re Yorkshire Woolcombers Association Limited; Houldsworth v Yorkshire Woolcombers Association Limited Ltd* [1903] 2 Ch 284 in respect of floating charges.

[72][139] The 2016 Explanatory Memorandum states that the reference to an interest in the financial property being "fixed and enforceable" means that circumstances arise such that the floating charge attaches to specific property and the grantor ceases to be able to deal with the property and the secured person has a presently exercisable right to take enforcement action in respect of the secured property: [1.147].

[73][140] Section 14A(3) of the Netting Act has the effect that security under which the grantor was free to deal with the financial property in the ordinary course of business at some time on or after creation of the security is taken not to be in the possession or under the control of a person even if the interest in the financial property becomes fixed and enforceable before the enforcement of

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Accordingly, a security which was historically considered to be a "floating charge" over all present and after-acquired property (or all present and after-acquired property of a particular class) should not, without more, satisfy the possession or control test for the purposes of the Netting Act.[141]

Circumstances where the financial property is in the possession or control of the ~~Clearing Member~~ FCM (or the person acting on their behalf)

Where there is an issuer of the financial property, that property is in the possession or control of the ~~Clearing Member~~ FCM (or relevant person acting on its behalf), if they are registered by, or on behalf of, the issuer as the registered owner of the financial property.[142] In a case where the financial property is intermediated financial property, that property is in the possession or control of the ~~Clearing Member~~ FCM (or relevant person acting on its behalf), if they are the person in whose name the intermediary maintains the account.[~~76~~143]

In addition, intermediated financial property would be under the possession or control of the ~~Clearing Member~~ FCM (or relevant person acting on its behalf), if:

(a) the intermediary is not the ~~Covered~~ Customer (but may be the ~~Clearing Member~~ FCM or any other person); and

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the security over financial property which is described in paragraph 14A(1)(b) of the Netting Act: 2016 Explanatory Memorandum, [1.147].

141 2016 Explanatory Memorandum, [1.147].

142 The 2016 Explanatory Memorandum provides at [1.153] that the "first limb of section 14A(4) is intended to cover the situations where the secured person or third party is registered by, or on behalf of, the issuer as the registered owner of the financial property, including where such registration happens on the Clearing House Electronic Sub- register System (CHESS) sub- register, maintained by ASX Settlement, or the issuer sponsored sub- register, maintained by the issuer or a share registry on the issuer's behalf".

~~76~~143 The 2016 Explanatory Memorandum provides at [1.153] that: "Due to the breadth of the concept of 'intermediary', this would include circumstances where, if the financial property is traded or settled through a clearing house or securities depository, the clearing house or securities depository, as the case may be, records the interest of the person in the financial property".

(b) there is an agreement in force between the intermediary and one or more other persons, one of which is the Clearing Member FCM or the Covered Customer, which has one or more of the following effects:

(i) the person in whose name the intermediary maintains the account is not able to transfer or otherwise deal with the financial property;

(ii) the intermediary must not comply with instructions given by the Covered Customer in relation to the financial property without seeking the consent of the Clearing Member FCM (or relevant person acting on its behalf); and

(iii) the intermediary must comply, or must comply in one or more specified circumstances, with instructions (including instructions to debit the account) given by the Clearing Member FCM in relation to the intermediated financial property without seeking the consent of the Covered Customer (or any person who has agreed to act on the instructions of the Covered Customer).

Further, the fact that the Covered Customer has one or more (or all) of the rights described below does *not* of itself mean that the Clearing Member FCM (or relevant person acting on its behalf) does not have possession or control or that the Covered Customer is free to deal with the financial property in the ordinary course of business:

(iA) right to receive and withdraw income in relation to the financial property;

(iiB) right to receive notices in relation to the financial property;

(iiiC) right to vote in relation to the financial property;

(ivD) right to substitute other financial property that the parties agree is of equivalent value for the financial property;

(vE) right to withdraw excess financial property; and

(viF) right to determine value of financial property.

For completeness, we note that the regulations may also prescribe circumstances in which financial property is, or is not, transferred or dealt with so as to be in the possession or under the control of a

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person for the purposes of the Netting Act. As at the date of this ~~memorandum~~opinion, there are no regulations prescribing such circumstances.

~~4.2 Enforceability against grantor and third parties~~

~~If Australian Law governs the validity of the security interest (the rules for which are described in paragraph C.II.1.2 above), then the PPSA provides that the security interest in collateral:~~

~~(a) is enforceable against a grantor only if the security interest has attached to the collateral; and~~

~~(b) is enforceable against a third party only if:~~

~~(i) the security interest is attached to the collateral; and~~

~~(ii) one of the following applies:~~

~~(A) the secured party possesses the collateral;~~

~~(B) the secured party has perfected the security interest by control (see below); or~~

~~(C) a written security agreement that provides for the security interest covers the collateral.~~

~~These concepts are discussed below. In relation to the requirement for a written security agreement, this would be satisfied by the Covered Base Agreement and CDA.[77]~~

~~4.3 Attachment~~

~~Once a security interest is attached to personal property, it is referred to as "**collateral**" under the PPSA. A security interest attaches to collateral under the PPSA when:~~

~~[77] Provided that the Covered Base Agreement and CDA are signed by the grantor of the security interest or otherwise adopted or accepted by the grantor by an act or omission that reasonably appears to be done with the intention of adopting or accepting the writing.~~

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(a) the grantor has rights in the collateral, or the power to transfer rights in the collateral to the secured party; and

(b) either:

(i) value is given for the security interest; or

(ii) the grantor does an act by which the security interest arises.

If collateral gives rise to proceeds, the security interest attaches to the proceeds unless the security agreement provides otherwise.

4.4 Perfection

If Australian law governs the perfection of the security interest (the rules for which are described in paragraph C.II.2 above), then the PPSA provides that a security interest is perfected under the PPSA if (relevantly):

(a) the security interest is temporarily perfected, or otherwise perfected, by force of the PPSA;[78] or

(b) all of the following apply:

(i) the security interest is attached to the collateral;

(ii) the security interest is enforceable against a third party; and

(iii) any of the following applies:

(A) a registration is effective with respect to the collateral;

(B) the secured party has possession of the collateral (other than possession as a result of seizure or repossession); or

[78] An example of this is in relation to proceeds, see paragraph (d) below.

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(C) the secured party has control of the collateral, provided that the collateral is, relevantly, an intermediated security, an investment instrument or an uncertificated negotiable instrument.

Registration, possession and control are considered below.

While the PPSA does not require a secured party to "perfect" its security interest in the collateral, if the secured party does not do so:

(I) another security interest may take priority (see paragraph C.IV.15 below);

(II) another person may acquire an interest in the collateral free of the secured party's security interest (see paragraph C.IV.15 and Schedule 6 below); and

(III) it may not be able to enforce the security interest against a grantor who becomes insolvent (see paragraph C.IV.17 below and Schedule 7 to this memorandum).

(a) *Perfection by registration*

A security interest can be perfected by the registration of a financing statement with respect to the security interest on the Personal Property Securities Register ("**PPS register**") maintained by the Registrar of Personal Property Securities.

A financing statement may be registered whether or not the personal property to which the statement relates, or any person who owns or has rights in that property, is located in Australia. Security interests can be registered before the security agreement is entered into and before or after a security interest attaches to the property described in the financing statement. A person may apply to register a financing statement if they believe on reasonable grounds that the person described in the financing statement as the secured party is, or will become, a secured party in relation to the collateral.

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A copy of the security agreement need not be lodged but certain persons may request a copy of the agreement from the secured party and the secured party must comply with this request within 10 business days unless exceptions apply.[79]

Transitional provisions with respect to registration

The PPSA has an effect on security interests and security agreements arising before 30 January 2012 ("**transitional security interests**"). The priority rules in the PPSA will apply to these security interests subject to the transitional provisions.

The transitional provisions provide that security interests registered on certain existing registers were to be migrated to the PPS register (for example, charges registered on the ASIC Register of Company Charges).[80] However, this is likely to be effective only to the extent that the charges were required to be registered under the *Corporations Act*.

Transitional security interests which were not migrated, or which were not registered on any existing registers, will need to be registered on the PPS register (or otherwise perfected) before the end of the two year transitional period in order to preserve priority (although before that time, they may be subject to "taking free" rules which may affect their priority, depending on the type of personal property).[81] This means that transactions which were not regarded as security

[79] It is possible that some additional wording in relation to confidentiality would be beneficial if registration were undertaken (if the contents of the security document are to be confidential). The PPSA allows certain interested persons to request a copy of the security agreement that provides for a security interest (together with other information) from a secured party. Interested persons include other secured creditors. The secured party must respond to the request within 10 business days of receiving the request unless various exceptions apply. One of the exceptions is that the secured party need not provide that information if the secured party has a confidentiality agreement with the debtor in writing which provides that neither of them will disclose information of the kind required to be provided. However, the confidentiality agreement will not apply if:

- the confidentiality agreement was made after the security agreement providing for the security interest is made;
- at the time the request is received, the debtor is in default under the security agreement;
- the debtor has given written authorisation for the disclosure of the information; or
- the information has been requested by the grantor or its auditor.

[80] See http://www.ppsr.gov.au/AbouttheRegister/MigratedRegistrations/Pages/default.aspx.

[81] See paragraph C.IV.15 and Schedule 6 below for further information on "taking free" rules.

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interests under previous Australian law but may be security interests under the PPSA, either because they are "in substance" security interests or deemed security interests, will need to be registered (or otherwise perfected).

Please see paragraph C.IV.15 below with respect to the priority of security interests under the transitional provisions.

(b) *Perfection by possession*

In most cases, a security interest can only be perfected by possession if physical possession of the collateral is possible, i.e. there is some tangible evidence of the collateral which can be possessed. For example, possession is possible for:

(i) negotiable instruments that are not evidenced by an electronic record;[82] and

(ii) investment instruments if they are evidenced by a certificate.[83]

The PPSA states that a secured party cannot have possession of personal property if the property is in the actual or apparent possession of the grantor or debtor or another person on their behalf. By contrast, the PPSA also states that a grantor or debtor cannot have possession of the personal property if the property is in the actual or apparent possession of the secured party or another person on their behalf. This suggests that third party custodian arrangements will be sufficient to give the secured party possession where the custodian is acting on behalf of the secured party.

(c) *Perfection by control*

A security interest in certain types of collateral can be perfected by the secured party taking control of the collateral. They are, relevantly, an uncertificated negotiable instrument, an

[82] Such possession requires that the person, or another person on its behalf, takes physical possession of the instrument.

[83] Such possession requires that the certificate specifies the person who is entitled to the investment instrument and that the transfer of the investment instrument may be registered on books maintained for that purpose by or on behalf of the issuer and either the possessor (or someone on its behalf) has possession of the certificate or the registered owner acknowledges in writing that it is holding possession on behalf of the possessor.

investment instrument or an intermediated security. Perfection by control confers greater priority than perfection by registration or possession.

The manner by which a secured party can take control depends on the type of personal property which is subject to the security interest:

(i) ***(negotiable instruments)*** control is taken over negotiable instruments which are not certificated if the instruments are able to be transferred in accordance with the operating rules of a clearing and settlement facility and there is an agreement in force under which the secured party (or a person who has agreed to act on the instructions of the secured party) controls the sending of some or all electronic messages or other electronic communications by which the instruments could be transferred. It is not possible to perfect by control a security interest in negotiable instruments which are certificated (but they can be perfected by possession);

(ii) ***(investment instruments)*** control is taken over investment instruments if:

(A) the issuer registers the secured party as the owner of investment instruments; or

(B) where the investment instruments are evidenced by a certificate, the secured party has possession of the instruments and the secured party (or a person who has agreed to act on the instructions of a secured party) is able to transfer the instrument to the secured party (or another person) or otherwise deal with the instruments. We consider that this control test will be satisfied if the grantor gives the relevant certificates together with executed blank transfer forms with an authority to complete them or a power of attorney to the secured party (or a person who has agreed to act on the instructions of the secured party); or

(C) where the investment instruments are not evidenced by a certificate, one of the following circumstances applies:

(I) the secured party has an agreement with the grantor to the effect that the secured party (or a person who has agreed to act on the

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instructions of the secured party) is able to initiate or control sending instructions by which the investment instrument could be transferred or otherwise dealt with; or

(II) the issuer registers another person (not the grantor or debtor) as the owner of the investment instrument on behalf of the secured party, or another person (not the grantor or debtor) acknowledges in writing that it holds the instrument on behalf of the secured party, and in each case there is an agreement with the secured party under which the secured party (or a person who has agreed to act on the instructions of the secured party) is able to initiate or control sending some or all electronic messages or other electronic communications by which the instrument could be dealt with;

(iii) ***(intermediated securities)*** control is taken over intermediated securities if:

(A) there is an agreement between the grantor and either or both of the intermediary and the secured party (of which the intermediary has notice, if it is not a party to it) which has the effect that:

(I) the intermediary must not comply with instructions given by the grantor in relation to the intermediated securities without seeking the consent of the secured party (or a person who has agreed to act on the instructions of the secured party); or

(II) the intermediary must comply, or must comply in one or more specified circumstances, with instructions (including instructions to debit the account) given by the secured party in relation to the intermediated securities without seeking the consent of the grantor (or any person who has agreed to act on the instructions of the grantor).

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For securities held by a licensed custodian or nominee, these control tests would require the secured party to enter into a control agreement with the relevant licensed custodian or nominee; or

(B) there is an agreement in force under which the secured party (or a person who has agreed to act on the instructions of the secured party) is able to initiate or control the sending of some or all electronic messages or other electronic communications by which the intermediated securities could be transferred or otherwise dealt with; or

(C) the securities account is maintained in the secured party's name or is maintained in the name of another person (other than the debtor or grantor) and that person acknowledges in writing that it holds the intermediated securities on behalf of the secured party; and

(iv) ***(intangible property)*** security interests over relevant intangible property including accounts may not be perfected by control.

(d) *Perfection of proceeds*

While control is sufficient to perfect a security interest in uncertificated negotiable instruments, investment instruments and intermediated securities, control is not sufficient to perfect the proceeds of such collateral.[84]

A security interest will be temporarily perfected over proceeds of the original collateral, but only for a period of 5 business days after such proceeds arise. The secured party will have to act to separately perfect the security in relation to these proceeds within this period. If they fail to do this, then they may lose priority, or may lose the benefit of the proceeds altogether.

[84] A security interest in proceeds is perfected if the security interest in the original collateral is perfected by a registration which describes the proceeds in a manner compliant with the regulations or which covers the original collateral (if the proceeds are of a kind that are within the description of the original collateral or if the proceeds consist of currency, cheques or an ADI account, or a right to an insurance payment or any other payment as indemnity or compensation for loss or damage to the collateral or proceeds).

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(e) *Continuous perfection*

A security interest currently perfected by control will have priority over a security interest perfected in another way regardless of when the control was established. However, priority between two security interests perfected by control is determined according to the time of perfection by control, provided that perfection has been continuous.

(f) *Summary on the need for registration*

If the secured party under the Covered Base Agreement and CDA receives and holds investment instruments and intermediated securities[85] in its own name (or with their custodian in its own name), then this should satisfy the requirements of control for investment instruments and intermediated securities in the PPSA. However, other relevant forms of collateral cannot be perfected by control. Furthermore, as noted in the paragraphs above, control provides only limited perfection in relation to proceeds and needs to be continuous to be effective.

Finally, to the extent that the Covered Base Agreement and CDA creates a security interest in circulating assets, control is insufficient to protect against the insolvency-related matters set out in paragraph C.IV.17. There are two tests under the PPSA for whether an asset is, or is not, a circulating asset (which means that the security interest over the asset will also be circulating). For certain assets (such as certain accounts and negotiable interests), the secured party must control the asset and register that it has control. For all other assets, the secured party must not have given the grantor express or implied authority to dispose of the assets.

Accordingly, although control is an effective perfection method under the PPSA, we suggest that secured parties consider the relevance of these risks and whether registration should be conducted in addition to perfecting by control.

[85] Intermediated securities may comprise cash collateral recorded in the same securities account as other intermediated securities such as indirectly held debt securities.

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4.5 The need for stamping

Previously, a liability for mortgage duty in respect of a Covered Base Agreement and CDA may have arisen if the Covered Base Agreement and CDA affected property located or taken to be located in New South Wales at relevant times. This type of stamp duty was abolished on and from 1 July 2016 and as a result, a mortgage duty liability should not arise in respect of a Covered Base Agreement and CDA on or after this date.

6 Other requirements for valid security interests

If there are any other requirements to ensure the validity or perfection of a security interest in each type of Eligible Collateral created by the Covered Customer under each Covered Base Agreement and CDA, please indicate the nature of such requirements. For example, is it necessary as a matter of formal validity that the Covered Base Agreement and CDA be expressly governed by the law of Australia or translated into any other language or for the Covered Base Agreement and CDA to include any specific wording? Are there any other documentary formalities that must be observed in order for a security interest created under each Covered Base Agreement and CDA to be recognised as valid and perfected in Australia?

Irrespective of whether the *Netting Act* applies, there are no particular additional requirements or formalities to ensure the validity or perfection of security interests in relation to the contemplated Eligible Collateral. It is not necessary as a matter of formal validity that the Covered Base Agreement and CDA be expressed to be governed by Australian Law or that they be translated into another language or for them to include specific wording.

7 Action required to maintain security interest

Assuming that the Clearing Member has obtained a valid and perfected security interest in the Eligible Collateral under the laws of Australia, to the extent such laws apply, by complying with the requirements set forth in your responses to questions 1 to 6 above, as applicable, will the Clearing Member or the Covered Customer need to take any action thereafter to ensure that the security interest in the Eligible Collateral continues and/or remains perfected, particularly with respect to

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additional Collateral transferred by way of security from time to time when required pursuant to the Covered Base Agreement and CDA.

Once any additional Eligible Collateral is transferred to the Clearing Member and is subject to the security interest in favour of the Clearing Member in accordance with the Covered Base Agreement and CDA, the validity, continuity, perfection or priority will be determined in the manner considered above. Where the *Netting Act* applies, this will be in accordance with the conditions set out under that Act and considered in paragraphs C.I.3 and C.II.5.1 below, where it does not, these will include the considerations outlined in paragraphs C.II.5.2 to C.II.5.4 below. Otherwise, no additional actions of this kind will be required, provided any additional Eligible Collateral is within the scope of the relevant Covered Base Agreement and CDA.

8 Requirements where Australian Law is not the governing law for validity and perfection

Assuming that (a) pursuant to the laws of Australia, the laws of another jurisdiction govern the creation and/or perfection of a security interest in the Eligible Collateral transferred by way of security pursuant to each Covered Base Agreement and CDA (for example, because such Collateral is located or deemed to be located outside Australia) and (b) the Clearing Member has obtained a valid and perfected security interest in the Eligible Collateral under the laws of such other jurisdiction, will the Clearing Member have a valid security interest in the Collateral so far as the laws of Australia are concerned? Is any action (filing, registration, notification, stamping or notarisation or any other action or the obtaining of any governmental, judicial, regulatory or other order, consent or approval) required under the laws of Australia to establish, perfect, continue or enforce this security interest? Are there any other requirements of the type referred to in question 6 above?

Where, as a matter of Australian Law, the laws of another jurisdiction govern the perfection, and the effect of perfection or non-perfection, of the security interest (as per the rules summarised in paragraph C.II.2 above), then, subject to the one PPSA rule specified below, if the Clearing Member has obtained a valid and perfected security interest pursuant to the laws of that other jurisdiction, then an Australian Court will recognise that the Clearing Member has a valid and perfected security interest in the Eligible Collateral. There are no actions required under Australian Law to perfect or enforce this

security interest or other requirements of the type referred to in question 6 above. However, certain procedural requirements would need to be met if a foreign judgment was sought to be enforced in an Australian Court.

Where the *Netting Act* does not apply, there is one PPSA rule which applies if:

(a) the jurisdictional provisions of the PPSA are satisfied (described in paragraph C.I.2.5 above);

(b) pursuant to the rules in the PPSA, Australian law does not govern the validity of the security interest (the rules for which are described in paragraph C.II.1.2 above); and

the laws of the jurisdiction that govern the perfection of a security interest in the Eligible Collateral do not provide for the public registration or recording of (c) the security interest or a notice relating to the security interest.[86]

In these circumstances, the PPSA provides that the security interest will have priority, in proceedings in an Australian Court, over another interest in personal property if:

(i) that security interest is perfected by registration under the PPSA before the other interest attaches to the personal property; and

(ii) except in the case of accounts (in which case only (A) above applies), when the other interest arises in the personal property, that property is located in Australia and the Clearing Member does not have possession or control of it.

This priority rule does not apply if (i) and (ii) are not satisfied.

This priority rule is not relevant to the extent that the *Netting Act* applies to protect the enforcement of a security where the Covered Customer or Clearing Member is subject to external administration

[86] It should be noted that with certain types of collateral this may not be relevant in the context of this memorandum. For example, in the case of a security interest in an account granted by an Australian Company the rules described in paragraph C.II.1.2 above will provide that Australian law governs validity and perfection.

governed by Australian law.[87] However, the priority rule continues to be relevant to an enforcement of security where the *Netting Act* protection does not apply, including prior to any such external administration.

Further, it is possible that further action would be needed if, as a result of relocation of the grantor or the property, Australian Law becomes applicable to perfection (and the effect of perfection or non-perfection).

9 Clearing Member duties

Are there any particular duties, obligations or limitations imposed on the Clearing Member in relation to the care of the Eligible Collateral held by it pursuant to each Covered Base Agreement and CDA?

The PPSA does not impose any duties on secured parties in relation to the care of collateral except in the exercise of enforcement rights provided for by the PPSA (in respect of which, please see paragraph C.III.11 below).

Under general Australian Law, the Clearing Member is under an obligation to take reasonable steps to ensure the safe custody of any secured property in its possession.[88]

10 Dealings with Collateral

A Covered Base Agreement and CDA may grant the Clearing Member broad rights with respect to the use of Collateral. Additionally, the Covered Base Agreement and CDA are subject to the rules of DCOs, which may also grant DCOs similar rights with respect to the use of Collateral that has been on-posted from a Clearing Member to a DCO. Such use might include pledging or rehypothecating the securities, disposing of the securities under a securities repurchase (repo) agreement or simply

[87] Where applicable, the *Netting Act* applies despite any other law (including, relevantly, the additional requirements imposed by the PPSA in relation to the enforceability, validity and perfection of security interests, the PPSA's priority framework and any vesting which could otherwise occur under the PPSA or *Corporations Act* due to non-perfection or a delay in perfection), albeit subject to the specified stay provisions.

[88] Although this obligation is usually applied in the context of tangible assets, if it were to be applied to intangible assets in the nature of dematerialised securities, we consider that a holding by a custodian of the relevant interests would satisfy these requirements.

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selling the securities. Do the laws of Australia recognise the right of the Clearing Member or DCO so to use such Collateral pursuant to an agreement with the Covered Customer? In particular, how does such use of the Collateral affect, if at all, the validity, continuity, perfection or priority of a security interest otherwise validly created and perfected prior to such use? Are there any other obligations, duties or limitations imposed on the Clearing Member or DCO with respect to its use of the Collateral under the laws of Australia? In considering the above question in relation to a DCO, please limit your response to the extent that rights or duties applicable to the DCO under the laws of Australia are relevant to the validity, continuity, perfection or priority of Clearing Member's security interest.

If Australian Law does not govern the validity, perfection and effect of perfection or non-perfection of security interests to which the PPSA applies (as to which, please see paragraphs C.II.1.2 and C.II.2 above), then in our view there is no reason in principle why an Australian Court would seek to interfere with such arrangements if they were valid as a matter of New York law. Please see paragraph C.V.18 below for discussion of the Australian position in relation to the recognition of New York law as the governing law of the Covered Base Agreement and CDA.

If Australian Law governs the validity and perfection of security interests to which the PPSA applies (as to which, please see paragraphs C.II.1.2 and C.II.2 above) then, we note that:

(a) the PPSA does not contain provisions which expressly authorise a Clearing Member or a third party such as a DCO to deal with the Collateral except where the Clearing Member seizes the Collateral pursuant to the exercise of a right to do so on default by the Covered Customer; and

(b) the PPSA provides that a security agreement is effective in accordance with its terms; and

(c) any such dealing may be characterised under Australian Law as constituting a prospective release by the Covered Customer of its interests in the affected Collateral, intended to take effect on the occurrence of such dealing.

As noted in paragraph C.II.5.1 above, a condition to protection under the *Netting Act* requires that the Eligible Collateral must be, before enforcement, transferred or otherwise dealt with so as to be in the possession or under the control of the Clearing Member, or another person (who is not the Covered Customer) on behalf of the Clearing Member under the terms of an arrangement evidenced in writing.

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Although this means that the Covered Customer cannot be free to deal with the Eligible Collateral in the ordinary course of its business, the fact that the Covered Customer has one or more (or all) of the following rights does *not* of itself mean that the Clearing Member or relevant third party does not have possession or control or that the Covered Customer is free to deal with the financial property in the ordinary course of business:

(i) right to receive and withdraw income in relation to the financial property;

(ii) right to receive notices in relation to the financial property;

(iii) right to vote in relation to the financial property;

(iv) right to substitute other financial property that the parties agree is of equivalent value for the financial property;

(v) right to withdraw excess financial property;

(vi) right to determine value of financial property.

The enforceability of any contractual obligations on a Clearing Member to return equivalent Collateral to the Covered Customer is a matter of New York law, being the governing law of the Covered Base Agreement and CDA.

III. ENFORCEMENT OF FUTURES NETTING RIGHTS, FUTURES CREDIT SUPPORT RIGHTS, CLEARED DERIVATIVES NETTING RIGHTS AND CLEARED DERIVATIVES CREDIT SUPPORT RIGHTS UNDER THE COVERED BASE AGREEMENT AND CDA BY THE CLEARING MEMBER IN THE ABSENCE OF AN INSOLVENCY PROCEEDING

We set out below our analysis of the issues raised under the heading "Enforcement of Futures Credit Support Rights and Cleared Derivatives Credit Support Rights under the Covered Base Agreement and CDA by the Clearing Member in the Absence of an Insolvency Proceeding" in Part III of the Instruction Letter. The different types of insolvency proceedings to which an Australian Company may be subject under Australian Law are described in paragraph B.2.5 above and Schedule 2 and, as noted in paragraph B.2.6 above, each of these insolvency proceedings falls within the definition of external administration for the purposes of the *Netting Act*. We assume in this Part III that neither the Covered Customer nor the Clearing Member is subject to such insolvency proceedings and,

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accordingly, that the *Netting Act* does not apply to the enforcement of security under the Covered Base Agreement and CDA.

11 Formalities in exercising enforcement rights

*Assuming that the Clearing Member has obtained a valid and perfected security interest in the Eligible Collateral under the laws of Australia, to the extent such laws apply, by complying with the requirements set forth in your responses to questions 1 to 6 above, as applicable, what are the formalities (including the necessity to obtain a court order or conduct an auction), notification requirements (to the Covered Customer or any other person) or other procedures, if any, that the Clearing Member must observe or undertake in enforcing its security interest in the Eligible Collateral and exercising its Futures Credit Support Rights and Cleared Derivatives Credit Support Rights ("**Credit Support Rights**") as a Clearing Member under each Covered Base Agreement and CDA, such as the right to liquidate the Eligible Collateral? For example, is it free to sell the Eligible Collateral (including to itself) and apply the proceeds to satisfy the Covered Customer's outstanding obligations under the Covered Base Agreement and CDA? Do such formalities or procedures differ depending on the type of Eligible Collateral involved?*

The specific PPSA 'governing law' provisions with respect to the validity and perfection of a security interest do not extend to enforcement issues.[89] For the reasons set out in paragraph C.II.1.2 above, in our opinion the better view is that, in the absence of any other legislation determining the law governing the enforcement of a security interest, the general Australian Law will determine the governing law.

If Australian Law governs the enforcement of a security interest and the PPSA applies, then the PPSA sets out a series of rules on the enforcement of security interests in personal property. These rules regulate how a secured party seizes, disposes of and retains collateral and procedural requirements and duties that the secured party may need to comply with if it exercises those rights under the PPSA.

[89] As noted in paragraph C.II.1.2 above, the PPSA contains provisions which set out which law, in proceedings in an Australian court, governs the validity, perfection and effect of perfection or non-perfection of security interests to which the PPSA applies.

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Some, but not all of these, can be contracted out of.[90] However, the rights, powers and remedies of a secured party under the enforcement provisions in the PPSA are in addition to, and do not replace, those under the Covered Base Agreement and CDA and the general law. In our view, if a Clearing Member exercises enforcement rights under a Covered Base Agreement or CDA[91] that are identical to the rights it is entitled to exercise under the PPSA and which the parties have not contracted out of, there is only a low risk that the secured party would have to comply with the PPSA procedural requirements and duties.[92] Also, with limited exceptions the enforcement provisions do not apply to a security interest over an investment instrument or intermediated security which is perfected by possession or control and do not apply to security granted by an Australian Company which is subject to a receiver, receiver and manager or a controller.[93] The most significant of the enforcement provisions is that which requires that personal property or proceeds of collateral received by or on behalf of a secured party as a result of enforcing a security interest in collateral must be applied in the following order whether the security interest was enforced under the PPSA or otherwise:

- higher ranking interests (other than security interests)
- reasonable enforcement expenses
- higher ranking security interests

[90] Those which cannot be contracted out of include: that rights, duties and obligations must be exercised honestly and in a commercially reasonable manner, the duty to exercise all reasonable care to obtain at least the market value for collateral and the order of application of money received on enforcement.

[91] References in Part C of this memorandum to enforcement rights under a Covered Base Agreement or CDA should be taken to be references to the enforcement of rights that form part of the Futures Netting Rights and Cleared Derivatives Netting Rights (as applicable) which the Clearing Member has to exercise remedies as a secured party under the Covered Base Agreement and CDA (as applicable).

[92] The reasons for this include that, traditionally, in the context of considering the enforcement of securities, enforcement under a security agreement has been distinguished from enforcement under rights conferred by the *Conveyancing Act 1919* of New South Wales (and its equivalent in other jurisdictions). By parity of reasoning, a similar conclusion should be reached in the context of the PPSA enforcement provisions. Also, there is no provision in the PPSA deeming that if a secured party exercises rights that are available under both the enforcement provision and the general law or contract it is deemed to be exercising the former.

[93] A controller is defined under the *Corporations Act* to mean a receiver, receiver and manager or anyone else who is in possession, or has control, of a corporation's property for the purpose of enforcing a security interest.

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- secured party
- lower ranking security interests
- grantor.

This provision may not be contracted out of and it does apply to a secured party who has perfected an investment instrument or intermediated security by taking possession or control. This means that a secured party cannot avoid this provision by taking possession or control.

The PPSA procedural requirements and duties that apply in respect of the enforcement of a security interest are not considered further in this memorandum.Under the general Australian Law, it is not necessary for any particular formalities to be followed in order to exercise the rights contemplated by each Covered Base Agreement and CDA, including the right to "liquidate" the Eligible Collateral by selling it. Accordingly, the Clearing Member may, on enforcement of the Covered Base Agreement and CDA, sell the Eligible Collateral. In particular, a court order or auction is not required and notice of sale need not be given to the Covered Customer, although in practice secured creditors do often give a short period of notice before selling Eligible Collateral. This does not differ depending on the type of Eligible Collateral involved.

In exercising its power of sale under the Covered Base Agreement and CDA, the majority of Australian cases suggest that a Clearing Member has a duty to act in good faith and not to wilfully or recklessly sacrifice the interests of the Covered Customer. However, in considering the Clearing Member's duty at equity, judicial statements have been made to the effect that an absence of good faith may be evidenced where the mortgagee:

(a) has acted "without taking reasonable steps to obtain a proper price";[94] and

(b) has acted without "a genuine primary desire to obtain for the mortgaged property the best price obtainable consistently with the right of the mortgagee to realise his security".[95]

[94] Mason J in *Forsyth v Blundell* (1973) 129 CLR 477.

[95] Jacobs J in *ANZ Banking Group v Bangadilly Pastoral* (1978) 52 ALJR 529.

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This duty is owed not only to the Covered Customer, but also to the Covered Customer's guarantors and subsequent security providers. On the other hand, a security holder is not required to delay the realisation of security in the expectation that a higher price may be obtained in the future. Generally, and subject to the principles just quoted, a security holder is free to determine when to exercise a power of sale.[96]

A controller of a company also owes a statutory duty under section 420A of the *Corporations Act*. In exercising a power of sale, a controller has a duty to take all reasonable care to sell the property for its market value (if, when sold, it has a market value) or otherwise the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold. This duty is a duty owed to the company. The controller may also owe duties to others under the general law. It is also possible for a person other than the company to take action to restrain the sale by applying for an injunction under section 1324 of the *Corporations Act* for a breach of section 420A. Section 1324 entitles a person whose interest would be affected by a contravention of the *Corporations Act* to apply for an injunction to prevent the contravention.

While there is no prohibition on the Clearing Member appropriating the Eligible Collateral to itself and applying the value of the Eligible Collateral to meeting the Covered Customer's obligations, it may have a harder time discharging the burden of proof that it complied with its equitable and statutory duties for the Eligible Collateral than it would have had selling the securities to a third party. However, it will, of course, be somewhat easier to establish that it acted reasonably and fairly in the circumstances, in relation to Eligible Collateral in the form of liquid securities, where a market price at the time of the Clearing Member's appropriation of the Eligible Collateral can be objectively established.[97]

See also our answer to Part C.IV.16 below.

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[96] *Tse Kwong Lam v Wong Chit Sen* [1983] 1 WLR 1349.

[97] Also, if the PPSA enforcement provisions apply, the purchase must be by public sale and the secured party must pay market value.

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12 Formalities where Australian Law is not the law governing the validity and perfection

Assuming that (a) pursuant to the laws of Australia, the laws of another jurisdiction govern the creation and/or perfection of a security interest in the Eligible Collateral transferred by way of security pursuant to each Covered Base Agreement and CDA (for example, because such Eligible Collateral is located or deemed to be located outside Australia) and (b) the Clearing Member has obtained a valid and perfected security interest in the Eligible Collateral under the laws of such other jurisdiction, are there any formalities, notification requirements or other procedures, if any, that the Clearing Member must observe or undertake in Australia in exercising its rights as a Clearing Member under each Covered Base Agreement and CDA?

If the laws of another jurisdiction govern the enforcement of the security interest (as to which, please see our response to question C.III.11 above), there are no other formalities, notifications or other procedures that the Clearing Member must observe or undertake in Australia in exercising its rights as a Clearing Member under each Covered Base Agreement and CDA. However, please see our answer in paragraph C.IV.16 below with respect to stay on rights.

13 Special limitations on enforcement

Are there any laws or regulations in Australia that would limit or distinguish a creditor's enforcement rights with respect to Eligible Collateral depending on (a) the type of transaction underlying the creditor's exposure, (b) the type of Eligible Collateral or (c) the nature of the creditor or the debtor? For example, are there any types of "statutory liens" that would be deemed to take precedence over a creditor's security interest in the Eligible Collateral?

In relation to entities of the kind covered by this memorandum, there are no rules or regulations of the kind mentioned in paragraphs (a), (b) or (c) of this question, although certain restrictions may apply in relation to other types of entities (such as the Crown and statutory corporations), particularly in relation to their power to enter into particular transactions and the assets of those entities available to satisfy particular kinds of obligations. Except as noted in paragraph C.III.11 above, the types of Eligible Collateral involved should not have any effect on enforcement rights considered in paragraph C.III.11.

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In certain circumstances certain claims may rank in priority (either in whole or in part) to a security interest including, without limitation:

(a) claims for the costs of administration and realisation;

(b) certain claims mandatorily preferred by law; and

(c) certain claims arising by operation of law or specifically charged by statute (including, without limitation, local government rates and land tax),

but in this regard the position of the Clearing Member is no different from any person taking similar security interests under Australian Law. Subject to such claims and the comments in paragraph C.V.20 below, there are no general "statutory liens" or preferred claims in relation to a security interest over Eligible Collateral of the kind under review.

However, as noted in paragraph C.I.3.3 and Part C.III, the protection provided to the enforcement of security under the *Netting Act* may be available on the external administration of the Clearing Member or the Covered Customer.

14 Collateral holder in default

How would your responses to questions 11 to 13 above change, if at all, assuming that an insolvency proceeding described in assumption (g) in section 1, Part B of Schedule 1 to this memorandum has occurred with respect to the Clearing Member (notwithstanding that the Covered Base Agreement and CDA may not provide for any events of default in respect of the Clearing Member) rather than or in addition to the Covered Customer (for example, would this affect theability of the Clearing Member to exercise its enforcement rights with respect to the Eligible Collateral)?

If an insolvency proceeding described in assumption (g) in section 1, Part B of Schedule 1 to this memorandum has occurred with respect to the Clearing Member rather than the Covered Customer, our responses to questions 11 to 13 above would not change.

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IV. ENFORCEMENT OF FUTURES NETTING RIGHTS, CLEARED DERIVATIVES NETTING RIGHTS AND CREDIT SUPPORT RIGHTS UNDER THE COVERED BASE AGREEMENT AND CDA BY THE CLEARING MEMBER AFTER COMMENCEMENT OF AN INSOLVENCY PROCEEDING

We set out below our analysis of the issues raised under the heading "Enforcement of Credit Support Rights Under the Covered Base Agreement and CDA by the Clearing Member after the Commencement of an Insolvency Proceeding" in Part III of the Instruction Letter.

The different types of insolvency proceedings to which an Australian Company may be subject under Australian Law are described in paragraph B.2.5 above and Schedule 2. As noted in paragraph B.2.6 above, each of these insolvency proceedings falls within the definition of external administration for the purposes of the *Netting Act*. We assume in this Part IV that the Covered Customer is subject to such insolvency proceedings and that the *Netting Act* does apply to the enforcement of security under the Covered Base Agreement or CDA. We note that the relevant protection given to enforcement of security applies only to the extent that the enforcement is carried out in a manner that complies with section 420A of the *Corporations Act* (if it applies) and any applicable general law duties that are not inconsistent with the terms of the security. In that regard, please see paragraphs C.I.3.9 and C.III.11 above.

This analysis proceeds on the assumption that the Covered Customer's assets are located in Australia. If any of its assets are located outside Australia, then the analysis will need to be supplemented by advice on the cross border insolvency regime that operates in the country in which the assets are located (ie there might be similar types of proceedings in that other country to the proceedings which can apply in Australia which are referred to in paragraph B.2.5 above).

15 Competing claims

How are competing priorities between creditors determined in Australia? What conditions must be satisfied if the Clearing Member's security interest is to have priority over all other claims (secured or unsecured) of an interest in the Eligible Collateral, other than claims of a DCO?

As discussed in paragraph C.I.3, where specified safeguards are met, the protection under the *Netting Act* of the enforcement of security (including the protection against the enforcement being void or voidable) applies despite:

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(a) the creation of any encumbrance, or any other interest, in relation to the financial property secured; or

(b) the operation of any encumbrance, or any other interest, in relation to that financial property,

in contravention of a prohibition in the contract or in the protected security.[98]

These protections apply despite any other law (including the "specified provisions"), but subject to applicable "specified stay provisions". The effect of this is considered further in our responses set out in paragraph C.IV.16 below. The protections apply to the enforcement of security over financial property, in respect of obligations of a party to a close-out netting contract, only to the extent that certain safeguards are satisfied. These are considered in paragraph C.I.3 above.

Where the enforcement of security under a Covered Base Agreement or CDA is not protected under the *Netting Act*,[99] there are priority rules under the PPSA and the *Corporations Act* which apply to determine:

(i) the priority between competing security interests attached to the same collateral;

(ii) in some cases, the priority between a security interest and another interest such as that of a purchaser); and

(iii) the priority of transitional securities.

Please see Schedule 6 for a more detailed description of these provisions.

16 Stay on rights

Would the Clearing Member's right to enforce its security interest in the Eligible Collateral and exercise its Credit Support Rights under each Covered Base Agreement and CDA, such as the right to liquidate

[98] Section 14(2)(h) of the *Netting Act*. The amendment to section 14(2)(h) of the *Netting Act* made by the *Collateral Protection Act* do not apply to disposals of rights or property, or the creation or operation of encumbrances or interests, before 1 June 2016 (*Collateral Protection Act*, Part 3).

[99] Please see our comments in paragraphs C.I.1 and C.I.3 above.

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the Eligible Collateral, be subject to any stay or freeze or otherwise be affected by commencement of the insolvency (that is, how does the institution of an insolvency proceeding change your responses to questions 11 and 12 above, if at all)?[100]

The effect of section 440B of the *Corporations Act* is that during the administration of an Australian Company, a security interest over the Australian Company's property cannot be enforced,[101] except with the leave of the court or the administrator's written consent.

A secured creditor holding security over substantially all of the assets of the Australian Company can effectively block the appointment of an administrator (this is because such a secured creditor has a 13 business day period after the appointment of an administrator to decide whether to enforce the security interest), but this would not apply in the case of the Covered Base Agreement and CDA (assuming that the Eligible Collateral provided by the Covered Customer does not comprise substantially all its assets).

However, to the extent that the *Netting Act* protects the enforcement of the security under a Covered Base Agreement and CDA, the protection applies despite any other law (including the specified provisions), but subject to applicable specified stay provisions. The specified provisions include the moratorium on the enforcement of security during the administration of an Australian Company under section 440B of the *Corporations Act* (and this is not a specified stay provision). Accordingly, the moratorium on enforcement during the administration of an Australian Company would not restrict the Clearing Member enforcing security to the extent that the *Netting Act* protects that enforcement.

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[100] For example, under the US Bankruptcy Code certain creditors are subject to an automatic stay, which limits a creditor's ability to take actions to enforce or collect upon a claim (subject to certain exceptions).

[101] "Enforce" is defined broadly by the *Corporations Act* to include, among other things, the exercise in relation to property of a right, power or remedy existing because of the security interest that arises (a) under an agreement or instrument relating to the security interest; (b) under an agreement or instrument relating to a transaction or dealing giving rise to the security interest (in the case of a PPSA security interest); (c) under a written or unwritten law; or (d) in any other way. Therefore, a secured party cannot resort to self-help measures that fall within the definition of "enforce" without the administrator's consent or leave of the court. This prohibition means that, amongst other restrictions, a Clearing Member may not "liquidate" Eligible Collateral which is under its control at the time administration commences. This prohibition does not, however, prevent a person from giving a notice under the provisions of an agreement or instrument under which a security interest is created or arises.

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Specified stay provisions

The *Collateral Protection Act* amended a number of stays which already existed in other Australian Acts to restrict the enforcement of security under a contract and set out a new framework in the *Netting Act* for the way in which these stays would cease to apply to close-out netting contracts and the security given over financial property in respect of close-out netting contracts. These stays, and the new framework, are considered in Schedule 4.

17 Clawback

Will the Covered Customer (or its administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official) be able to recover any transfers of Collateral made to the Clearing Member during a certain "suspect period" preceding the date of the insolvency as a result of such a transfer constituting a "preference" (however called and whether or not fraudulent) in favour of the Clearing Member or on any other basis? If so, how long before the insolvency does this suspect period begin? If such a period exists, would the substitution of Collateral by the Covered Customer during this period invalidate an otherwise valid security interest if the substitute Collateral is of no greater value than the assets it is replacing? Would the posting of additional "variation margin" (an amount that reflects a change in the mark-to-market value of one or more Covered Transactions) during the suspect period be subject to avoidance, either because the Collateral was considered to relate to an antecedent or pre-existing obligation or for some other reason?

Under Australia insolvency laws, transactions may be void, voidable or vest in the grantor in certain circumstances, which are considered in Schedule 7 to this memorandum.

However, to the extent that the *Netting Act* protects the enforcement of the security under a Covered Base Agreement or CDA, the protection of enforcement applies despite any other law (including the specified provision), but subject to applicable specified stay provisions and noting the circumstances affecting the *Netting Act* protection (as described in paragraph 6 of Schedule 3 (referred to in paragraph C.I.3.8 above)). The specified provisions are defined in the *Netting Act* to include many of the Australian insolvency laws referred to above. Further, even where such laws are not specified provisions, the *Netting Act* protection applies "despite any other law". Consequently, the *Netting Act* protection applicable to enforcement of security applies despite those Australian insolvency laws.

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In addition, the enforcement of security which is protected under the *Netting Act* is not to be void or voidable in the external administration, subject to the application of either of the two limitations set out in paragraph 6 of Schedule 3 (referred to in paragraph C.I.3.8 above).

V. MISCELLANEOUS

We set out below our analysis of the issues raised under the heading "Miscellaneous" in Part III of the Instruction Letter.

18 Governing law of Covered Base Agreement and CDA

Would the parties' agreement on the governing law of each Covered Base Agreement and CDA and submission to jurisdiction be upheld in Australia, and what would be the consequences if they were not?

In any proceedings properly commenced by the Clearing Member against the Covered Customer in an Australian Court claiming enforcement of a Covered Base Agreement and CDA governed by a law other than Australian Law, the choice of that other law as the law by which the relevant Covered Base Agreement and CDA is to be governed would be upheld as a valid choice of law and would be applied by the Australian Court, provided that:

(a) the choice of law had been made in good faith and was not intended to evade the provisions of another legal system with which the Covered Base Agreement and CDA had a closer connection; and

(b) none of the terms of the relevant Covered Base Agreement and CDA or any provision of that law applicable to the Covered Base Agreement and CDA is contrary to Australian public policy (we consider that it is very unlikely that an Australian Court would reach such a conclusion where the governing law is New York law).

We express no opinion as to whether a court will give effect to a choice of laws to govern the Covered Base Agreement and CDA to the extent that the choice of laws applies to non-contractual obligations arising out of, or in connection with, the Covered Base Agreement and CDA (including, without limitation, non-contractual obligations within the meaning of Regulation No 864/2007 of the European

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Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (known as "Rome II")).

If the parties' agreement on the governing law and their submission to jurisdiction were not upheld, the relevant Covered Base Agreement and CDA would have to be examined by an Australian Court on the basis of Australian Law.

These types of proceedings are unusual and it is difficult to be precise about rules a court will adopt because much depends on the facts and the court has a wide discretion.

19 Other issues

Are there any other local law considerations that you would recommend the Clearing Member to consider in connection with taking and realising upon the Eligible Collateral from the Covered Customer?

Please see paragraph C.IV.15 above and Schedule 6 below with respect to the relevance of the priority rules in the *Corporations Act* to the priority of transitional securities in circumstances where the *Netting Act* protection does not apply.

20 Other circumstances that might affect enforcement

Are there any other circumstances you can foresee that might affect the Clearing Member's ability to enforce its security interest in Australia?

General comments applicable to all Australian Companies

Other factors which might affect the Clearing Member's ability to enforce its security interest in Australia include the provisions of the *Corporations Act* dealing with transactions with related parties, the presence of fiduciary duties, whether or not the Covered Base Agreement and CDA have been entered into for bona fide commercial reasons and on arms-length terms, the discretions of an Australian Court with respect to the availability of equitable remedies (including, without limitation, injunction and specific performance) and the effect of other rules of law and equity. Also, the rights of a party to enforce a document may be limited or affected by its own breaches or misrepresentations

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and its own unlawful conduct (for example, if it did not hold authorisations which it is required to hold in order to conduct its business). In addition, claims of certain creditors are mandatorily preferred by law.

Comments applicable to specific types of Australian Companies ADIs and insurers

Specific priority regimes apply to the assets of ADIs, life companies and general insurers under section 13A(3) of the *Banking Act* and section 86 of the *Reserve Bank Act*, section 116(3) of the *Insurance Act* and section 187 of the *Life Insurance Act*. These are summarised further in Schedule 8 to this memorandum.

However, as noted above, to the extent that the *Netting Act* protects the enforcement of the security under a Covered Base Agreement or CDA, it applies despite any other law (including the specified provisions), but subject to applicable specified stay provisions. Some of the sections referred to above are included in the amended definition of "specified provisions". However, even where such sections are not specified provisions, the *Netting Act* protection applies "despite any other law". Consequently, the *Netting Act* protection applies despite those Australian insolvency laws.

Also, as noted above in our answer to paragraph C.IV.16 above, the *Netting Act* protection of enforcement of security applies subject to the specified stay provisions, which are particularly relevant to ADIs, general insurers and life companies.

Superannuation trustees and life companies

Superannuation trustees and life companies are restricted by the *Superannuation Industry (Supervision) Regulations 1994* (Cth) and the *Life Insurance Act* from granting charges over regulated superannuation funds or approved deposit funds, or its statutory funds (respectively). Those restrictions are subject to limited exceptions, which were amended by the *Collateral Protection Regulation*. The Explanatory Statement to the *Collateral Protection Regulation* states the following:

> *The* [Collateral Protection Regulation] *will:*
>
> (a) *enable trustees of superannuation funds and approved deposit funds (Superannuation Funds) regulated under the SIS Act and life companies regulated under the Life Insurance Act to provide margin by way of security in*

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relation to derivatives in the manner required to access international capital markets and liquidity; and

(b) *update the list of approved bodies (being domestic and foreign exchanges and clearing houses) to whom trustees of Superannuation Funds and life companies may grant security.*

This is intended to allow those entities to access liquid global markets such as the United States cleared over-the-counter (OTC) derivatives market through Futures Commission Merchants (FCMs).

The amended exceptions apply only where certain requirements that are set out in them are satisfied, consideration of which is beyond the scope of this memorandum on enforceability of valid security arrangements. However, by way of summary, we note that these conditions include that the security is required by applicable law, or the rules of an "approved body" (which are markets and clearing houses listed in the regulations). There is also a further extension to allow charges to be given to secure obligations under derivative contracts over "financial property" which links to the changes made in the reform package to address global derivative margining requirements.

Accordingly, if a particular Covered Base Agreement and CDA is used when the Covered Customer is such an entity, legal advice should be obtained that the security interest proposed is permissible under the applicable Australian statutes.

Yours faithfully

SCHEDULE 1

Assumptions and qualifications

1. Assumptions

Following are the assumptions set out in the Instruction Letter which we have been instructed to assume in preparing this memorandum.

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Part A

(a) On the basis of the terms and conditions of a Covered Base Agreement and CDA and other relevant factors, and acting in a manner consistent with the intentions stated in the Covered Base Agreement and CDA, the parties over time enter into a number of Covered Transactions that are intended to be governed by the Covered Base Agreement and CDA. The Covered Transactions entered into include any or all of the transactions described in Appendix A.

(b) Some of the Covered Transactions provide for an exchange of cash by both parties and others provide for the physical delivery of shares, bonds or commodities in exchange for cash.

(c) After entering into these Covered Transactions and prior to the maturity thereof, the Covered Customer becomes the subject of a voluntary or involuntary case under the insolvency laws of your jurisdiction and, subsequent to the commencement of the insolvency, either the Covered Customer or an insolvency official seeks to assume the profitable Covered Transactions for the Covered Customer and reject the unprofitable Covered Transactions for the Covered Customer or otherwise prevent the exercise of close-out rights by the Clearing Member.

Part B

(a) Pursuant to the relevant Covered Base Agreement and CDA, the counterparties agree that Collateral will include cash credited to an account (as opposed to physical notes and coins) and certain types of securities (as further described below) that are located or deemed located either (i) in your jurisdiction, or (ii) outside your jurisdiction ("Eligible Collateral"). If your analysis under Part I is based on the security interest held by the Clearing Member in the Covered Customer's right, title and interest in (i) its contractual rights under its Futures Transactions and Cleared Derivatives Transactions, (ii) its right to payment from DCOs in respect of those Futures Transactions and Cleared Derivatives Transactions and (iii) the proceeds of such rights, please also assume that "Eligible Collateral" includes these rights for purposes of answering the questions.

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(b) Please assume that any securities provided as Eligible Collateral are denominated in either the currency of your jurisdiction or any freely convertible currency and consist of (i) corporate debt securities whether or not the issuer is organized or located in your jurisdiction; (ii) debt securities issued by the government of your jurisdiction; and (iii) debt securities issued by the government of a member of the "G-10" group of countries, in one of the following forms:

(i) directly held bearer debt securities: by this we mean debt securities issued in certificated form, in bearer form (meaning that ownership is transferable by delivery of possession of the certificate) and, when held by a Clearing Member or a DCO as Collateral under a Covered Base Agreement and CDA, held directly in this form by the Clearing Member or a DCO (that is, not held by the Clearing Member or DCO indirectly with an Intermediary (as defined below));

(ii) directly held registered debt securities: by this we mean debt securities issued in registered form and, when held by a Clearing Member or DCO as Collateral under a Covered Base Agreement and CDA, held directly in this form by the Clearing Member or DCO so that the Clearing Member or DCO is shown as the relevant holder in the register for such securities (that is, not held by the Clearing Member or DCO indirectly with an Intermediary);

(iii) directly held dematerialized debt securities: by this we mean debt securities issued in dematerialized form and, when held by a Clearing Member or DCO as Collateral under a Covered Base Agreement and CDA, held directly in this form by the Clearing Member or DCO so that the Clearing Member or DCO is shown as the relevant holder in the electronic register for such securities (that is, not held by the Clearing Member or DCO indirectly with an Intermediary);

(iv) intermediated debt securities: by this we mean a form of interest in debt securities recorded in fungible book entry form in an account maintained by a financial intermediary (which could be a central securities depositary ("CSD") or a custodian,

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nominee or other form of financial intermediary, in each case an "Intermediary") in the name of the Clearing Member or DCO where such interest has been credited to the account of the Clearing Member or DCO in connection with a transfer of Collateral by the Covered Customer to the Clearing Member under a Covered Base Agreement and CDA.

The precise nature of the rights of the Clearing Member in relation to its interest in intermediated debt securities and as against its Intermediary will be determined, among other things, by the law of the agreement between the Clearing Member and its Intermediary relating to its account with the Intermediary, as well as the law generally applicable to the Intermediary, and possibly by other considerations arising under the general law or the rules of private international law of your jurisdiction. The Clearing Member's Intermediary may itself hold its interest in the relevant debt securities indirectly with another Intermediary or directly in one of the three forms mentioned in (i), (ii) and (iii). In practice, there is likely to be a number of tiers of Intermediaries between the Clearing Member and the issuer of such securities, at least one of which will be an Intermediary that is a national or international CSD.

Our expectation is that the Clearing Member will normally hold debt securities in the form of intermediated debt securities rather than directly in one of the three forms mentioned in (i), (ii) and (iii).

(c) Due to regulatory requirements, Collateral posted will be held by intermediaries in a way that identifies the Collateral as belonging to customers of the Clearing Member. For example, if the Collateral is held by the Clearing Member or an intermediary of the Clearing Member, that account will show that it is held for customers generally and the Clearing Member's books will show that the collateral is held for the individual customer. If the Collateral is held by the DCO or an intermediary of the DCO, that account will show that it is held for customers generally and the DCO's books will show that the Collateral is held for the individual customer.

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(d) Please assume that cash Collateral is denominated in a freely convertible currency and is held in an account under the control of the Clearing Member or DCO.

(e) In the case of cash Collateral that is transferred to a Clearing Member as margin, such cash Collateral can be viewed either as a transfer of title in that cash to the Clearing Member, or as collateral in which the Clearing Member can take a security interest. Under the first alternative, the Clearing Member can be viewed as receiving such cash Collateral as a principal and therefore having a right to net that cash margin against amounts owing from the Covered Customer to the Clearing Member. A supporting fact for this view is if the Clearing Member is paying the Covered Customer interest on such cash Collateral. Alternatively, if the Clearing Member holds such cash Collateral as agent, it would need to perfect its security interest in such cash Collateral. If the treatment of cash Collateral is subject to similar alternate analyses in your jurisdiction, please advise as to the proper treatment under each alternative.

(f) In the case of questions 11 to 14, please also assume that after entering into the Covered Transactions and prior to the maturity thereof, an event of default exists and is continuing with respect to the Covered Customer, and/or the Clearing Member has designated a date to begin exercising its Futures Liquidation Rights or Cleared Derivatives Liquidation Rights (a "Liquidation Date") as a result thereof (however, an insolvency proceeding has not been instituted, which is addressed separately in assumption (g) and questions 15 to 17).

(g) In the case of questions 15 to 17, please assume that a formal bankruptcy, insolvency, liquidation, reorganization, administration or comparable proceeding (collectively, the "insolvency") has been instituted by or against the Covered Customer and an event of default has accordingly occurred under the Covered Base Agreement and CDA. If there are different types of insolvency proceedings under the laws of your jurisdiction (for example, bankruptcy or liquidation proceedings where an entity does not emerge as a going concern, on the one hand, and a reorganization or administration proceeding where an entity is restructured and does continue as a going concern, on the other hand), please briefly describe the different types of proceedings and answer each question with respect to each

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such proceeding.

Part C

We have also assumed that:

(a) each party to the Covered Base Agreement and CDA is validly incorporated under the laws of its place of incorporation;

(b) each Covered Base Agreement and CDA is a legal, valid, binding and (except as expressly opined on in this memorandum) enforceable obligation of each party under all applicable laws;

(c) each party has duly authorised, executed and delivered each Covered Base Agreement and CDA prior to the commencement of any external administration against it and has the capacity to enter into and perform its respective obligations under each Covered Base Agreement and CDA;

(d) each Covered Base Agreement and Futures Transactions thereunder, and each CDA and Cleared Derivatives Transactions thereunder, form a single agreement between the Covered Customer and Clearing Member under all applicable laws;

(e) no external administration of the Covered Customer or the Clearing Member has commenced, or is taken to have commenced, at the time that a transaction is created, or Futures Credit Support or Cleared Derivatives Credit Support is transferred, under the Covered Base Agreement and CDA;

(f) that a court in the Australian Jurisdictions would recognise the validity of the choice of New York law as governing each Covered Base Agreement and CDA (in respect of which, see C.V.18 above);

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(g) the Covered Transactions are not void under gaming and betting legislation and are not in the nature of insurance;[102]

(h) none of the circumstances are present which could affect the availability of the Netting Act (these circumstances are described in paragraph 6 of Schedule 3);

the rights and obligations of the parties to (i) the Covered Base Agreement and CDA would be determined on the basis of the plain meaning of the assumptions set out in the Instruction Letter; and

(j) any external administration of the Covered Customer or the Clearing Member commences after 1 June 2016.

2. Qualifications

Our opinion is subject to the following qualifications:

(a) the insolvency-related analysis in this memorandum is restricted to the position where the relevant insolvency proceedings are governed by Australian Law. We express no opinion as to whether Australian Law would, in fact, govern such proceedings, whether or not conducted in the courts of an Australian Jurisdiction;

(b) we express no opinion as to the regulatory capital treatment of the transactions envisaged by the Covered Base Agreement and CDA with respect to either the Covered Customer or the Clearing Member;

(c) the nature and enforcement of rights and obligations may be affected by lapse of time, failure to take action or laws (including, without limitation, laws relating to the enforcement of security interests or insolvency), certain equitable remedies and defences generally affecting creditors' rights;

[102] Due to an amendment of the *Corporations Act* (see section 1101I, *Corporations Act*), financial products (including derivatives) are now protected from the operation of gaming and betting legislation in the *Australian jurisdictions*.

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(d) the statutory regime governing personal property securities and the enforcement of security given over financial property, in respect of obligations of a party to a close-out netting contract in Australia incorporates new concepts into Australian Law many of which, as at the date of this memorandum, have not been the subject of detailed analysis in the superior courts of Australia;

(e) the rights of a Clearing Member to enforce the Covered Base Agreement or CDA may be limited or affected by:

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

(ii) conduct of that party in relation to the relevant Covered Base Agreement or CDA which is unlawful including without limitation the failure to hold an Australian financial services licence if required to do so or the failure to comply with obligations in connection with that licence; or

(iii) conduct of that party in relation to the relevant Covered Base Agreement or CDA which gives rise to an estoppel or claim against that party by the party against whom it is seeking to enforce its rights under the relevant Covered Base Agreement or CDA;

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

(g) an unsecured creditor's right of recourse to trust assets to satisfy a trustee's liability depends on the availability of the trustee's right of indemnity out of those assets (and each creditor's right of subrogation to the trustee's right of indemnity). The trustee's right of indemnity may be not available to the extent that the liability was not properly incurred or was beyond the trustee's authority or the trustee is, or has been, in breach of trust (including an existing or future breach which is not related to the transactions contemplated by the relevant Covered Base Agreement or CDA);

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(h) the beneficiaries of a trust who have full legal capacity and whose interests have vested may terminate the trust and require the trustee to transfer the trust property to them (or as they direct) despite any provision to the contrary in the documents creating or evidencing the trust, or any other document. However, a trustee has a right to be indemnified out of, and an equitable lien over, trust assets in respect of debts and liabilities properly incurred by it as trustee, and those rights normally have priority over the claims of the beneficiaries. This priority benefits the creditors in respect of those debts and liabilities if and to the extent they are entitled to be subrogated to that right of indemnity and lien. These outcomes assume no disentitling conduct on the part of the trustee or a relevant creditor;

(i) the availability of certain equitable remedies (including, without limitation, injunctionsand specific performance) is at the discretion of a court in the Australian Jurisdictions;

(j) this memorandum does not consider the impact of insolvency laws, other than the insolvency laws of the Australian Jurisdictions;

(k) an obligation which imposes a detriment on a party may be unenforceable in its entirety or to the extent that the detriment exceeds the amount of the relevant loss or damage, if that detriment is held to constitute a penalty;

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

the term "enforceable" as used in this memorandum means that the relevant obligations are of a type that the courts in (m) the Australian Jurisdictions enforce and does not mean that these obligations will necessarily be enforced in all circumstances in accordance with their terms. The power of the courts of the Australian Jurisdictions to order specific performance of an obligation or to order any other equitable remedy is discretionary and, accordingly, such a court might make an award of damages where specific performance of an obligation or any other equitable remedy was sought. Further, if a company is subject to Insolvency Proceedings, provisions of the *Corporations Act* restrict the steps that may be taken against an insolvency officer in the event of Insolvency Proceedings and prescribe the manner in which claims may be made against an entity the subject of insolvency procedures

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in the Australian Jurisdictions, for example, by prescribing the procedure for making a claim against a company in liquidation;

(n) the laws of the Australian Jurisdictions may require that:

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

(ii) discretions are exercised reasonably; and

(iii) opinions are based on good faith;

(o) the question whether a provision of a Covered Base Agreement or CDA which is invalid or unenforceable may be severed from other provisions is determined at the discretion of a court in the Australian Jurisdictions;

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

(q) we express no opinion as to:

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

(ii) any provision of the Covered Base Agreement or CDA referring to legal concepts existing under foreign law;

(iii) the taxation or stamp duty consequences of a party entering the Covered Base Agreement or CDA or transaction under an Covered Base Agreement or CDA;

(iv) whether goods and services tax is payable in connection with the transactions contemplated by the Covered Base Agreement or CDA; or

(v) the obligations of an Australian financial services licensee or any other licensee in connection with its licence;

(r) we express no opinion in relation to:

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

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(ii) any law which has been enacted and has not commenced, or if it has commenced, has not started to apply;

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

(iv) the implications of any of them;

(s) regulations in Australia restrict or prohibit payments, transactions and dealings with assets having a prescribed connection with certain countries or named individuals or entities subject to international sanctions or associated with terrorism;

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

(u) a party entering into an Covered Base Agreement or CDA may, in doing so, be acting, or later be held to have acted, in the capacity of a trustee under an undocumented or partially documented constructive, implied or resulting trust which may have arisen as a consequence of that party's conduct;

(v) a court will not give effect to a currency indemnity, a choice of laws to govern the Covered Base Agreement or CDA or a submission to the jurisdiction of certain courts if to do so would be contrary to public policy in the Australian Jurisdictions, but we are not aware of any such public policy which would be applicable as at the date of this memorandum. We also express no opinion as to whether a foreign judgment in relation to a non-contractual obligation would be enforced in the Australian Jurisdictions;

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

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

(y) we express no opinion as to the validity or enforceability of any contract (including any lease) or debt which may be subject to a security interest in the Covered Base Agreement or CDA;

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(zz) in order to enforce a foreign judgment in the Australian Jurisdictions it may be necessary to establish that the judgment either:

(i) if it is a non-money judgment, qualifies as one of the relevant kinds of non-money judgment in respect of a country listed in the Foreign Judgments Regulations; and

(ii) is for a fixed and certain sum of money,

and is not in the nature of a penalty or revenue debt and, if raised by the judgment debtor, it may be necessary to establish that:

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

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

(iii) the subject matter of the proceedings giving rise to the judgment was not immovable property situated outside the jurisdiction which is the governing law of the relevant Covered Base Agreement or CDA;

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

(bb) we do not comment on the possible impact of a party failing to comply with a regulatory requirement applicable to it (for example, failing to obtain an Australian Financial Services Licence if it were required to do so) on the enforceability of a Covered Base Agreement or CDA;

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(cc) we express no opinion as to whether or not a foreign court (applying its own conflict of laws rules) will act in accordance with the parties' agreement as to jurisdiction, arbitration and/or choice of law;

(dd) as a matter of law of the Australian jurisdictions, claims may become barred under the Limitation Acts;

(ee) no view is expressed as to penalty interest, post-insolvency interest, conclusivity clauses, the availability of specific performance or injunction, the efficacy of liability exculpation clauses, severability clauses or indemnities for litigation costs; and

(ff) no view is expressed as to the accuracy, completeness or suitability of any formula set out in any Covered Base Agreement or CDA. If any formula is inaccurate, incomplete or unsuitable for the purpose of determining the amounts or matters for which it has been included, then a court may find that the relevant formula is void for uncertainty.

SCHEDULE 2

Insolvency proceedings under the laws of an Australian Jurisdiction

1. Winding Up

An Australian Company may become subject to winding up under Parts 5.4, 5.4A, 5.4B, 5.4C and 5.5 of the *Corporations Act*. This may be:

(a) a winding up effected by the court (including a winding up in insolvency); or

(b) a voluntary winding up approved by special resolution of an Australian Company's members; or

(c) a winding up ordered by the Australian Securities and Investments Commission.

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The Australian Company that is being wound up falls within the definition of a Chapter 5 body corporate in the *Corporations Act* and therefore the definition of external administration in the *Netting Act*.

2. Compromise or arrangement

An Australian Company may become subject to a compromise or arrangement under Part 5.1 of the *Corporations Act*. Under this procedure, proposals between the Australian Company and its creditors (or a class of them) for a compromise or arrangement in satisfaction of its debts can, if resolved by the requisite number of creditors (and sanctioned by the court), bind all its creditors (or the relevant class).

The *Australian Company* that has entered into a compromise or arrangement with another person the administration of which has not been concluded falls within the definition of a Chapter 5 body corporate in the *Corporations Act* and therefore the definition of external administration in the *Netting Act*.

3. Administration

An Australian Company may become subject to administration in accordance with Part 5.3A of the *Corporations Act*. An administrator may be appointed by the Australian Company by writing if its board of directors have resolved by majority that the Australian Company is insolvent or likely to become insolvent at some future time and that an administrator should be appointed. In addition, an administrator may be appointed by a liquidator, provisional liquidator or (where there is no liquidator or provisional liquidator in office) a person who is entitled to enforce a security interest over the whole or substantially the whole of the Australian Company's property if the security interest has become and is still enforceable.

During the time from the commencement of the administration to the adoption by the Australian Company and its creditors of a deed of company arrangement, there are a number of restrictions imposed on the Australian Company and its creditors. All of the Australian Company's assets are subject to the administrator's control except for property subject to security interests which were

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already being enforced as at the commencement of the administration. Even then a court may restrict the action of secured creditors if such action may prejudice the administration. By way of exception a person who holds a security interest over the whole or substantially the whole of the Australian Company's property can enforce that security interest provided the security interest is enforced in relation to all that property within 13 business days from the commencement of the administration.

The Australian Company that is under administration or that has executed a deed of company arrangement that has not yet terminated falls within the definition of a Chapter 5 body corporate in the *Corporations Act* and therefore the definition *of* external administration in the *Netting Act*.

4. Receiver

A receiver or receiver and manager may be appointed to an Australian Company. Such appointment would usually be made by a secured creditor of the Australian Company. The receiver would act on behalf of the secured creditor to realise the secured assets of the Australian Company and to manage the Australian Company's affairs with a view to satisfying the secured creditor's debts. The power to appoint a receiver or receiver and manager will normally originate from a security interest granted by the Australian Company to the secured creditor.

The Australian Company in respect of which a receiver or a receiver and manager has been appointed (whether or not by a court) and is acting falls within the definition of a Chapter 5 body corporate in the *Corporations Act* and therefore the definition of external administration in the *Netting Act*.

5. Appointment of a statutory manager in respect of an ADI

APRA has the power to assume control of an ADI in difficulty under the *Banking Act*.

APRA may appoint a statutory manager (which may be APRA itself or an administrator appointed by it) to take control of the business of the ADI, if:

(a) the ADI informs APRA that the ADI considers that it is likely to become unable to meet its obligations or that it is about to suspend payment; or

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(b) APRA considers that, in the absence of external support:

(i) the ADI may become unable to meet its obligations; or

(ii) the ADI may suspend payment; or

(iii) it is likely that the ADI will be unable to carry on banking business in Australia consistently with the interests of its depositors or with financial system stability in Australia; or

(c) the ADI becomes unable to meet its obligations or suspends payment.

Such control must continue until:

(A) the deposit liabilities of the ADI in Australia have been repaid (or APRA is satisfied that suitable provision has been made for their repayment) and APRA considers that it is no longer necessary for the statutory manager to remain in control of the ADI's business; or

(B) APRA considers that the ADI is insolvent and is unlikely to be returned to solvency within a reasonable time and APRA has applied for the ADI to be wound up in insolvency under the *Corporations Act*.

The statutory manager has the power and functions of the members of the board of directors (collectively and individually), including the board's powers of delegation. In addition, the statutory manager has specific powers, including to sell or otherwise dispose of the whole or any part of the ADI's business on any terms and conditions that the statutory manager considers appropriate.

There are restrictions on commencing or continuing court proceedings against the ADI while a statutory manager is in control of the ADI. In addition, the appointment of any liquidator, provisional liquidator, receiver or administrator is terminated when a statutory manager takes control of an ADI and no such official may be appointed while the statutory manager is in control of the ADI's business unless APRA approves the appointment.

The appointment of a statutory manager under the Banking Act falls explicitly within the definition of "external administration" under the *Netting Act*. However, the impact of a party's ability to close out

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Covered Transactions relating to, and enforcing security under, a Covered Base Agreement or CDA of:

(i) the appointment of a statutory manager; or

(ii) the statutory manager doing an act to facilitate recapitalisation,

is considered in detail in Schedule 4.

For completeness, we note that if an ADI becomes unable to meet its obligations or suspends payment, the assets of the ADI in Australia are to be available to meet the ADI's liabilities in the order prescribed under the *Banking Act*. However, we consider that this does not override the operation of the *Netting Act* because, as described in paragraph B.2.7, the *Netting Act* expressly provides that it is to take effect "despite any other law" (including section 13A(3) of the *Banking Act*).

6. Appointment of a judicial manager in respect of a life company

The *Life Insurance Act* defines a "life company" to be a company that is carrying on life insurance business in Australia. A life insurance business is essentially a business that consists of the issuing of life policies or sinking fund policies or the undertaking of liability under such policies and related business. A detailed definition is contained in section 11 of the *Life Insurance Act*.

On an application from APRA or the life company, an Australian Court may appoint a judicial manager to a life company (or part of the business of a life company).

The court may make an order that a life company (or part of the business of a life company) be placed under judicial management if it is satisfied that:

(a) both:

(i) the life insurance business of the company has been investigated by APRA (essentially, under Division 3 of Part 7 of the *Life Insurance Act*, APRA may investigate a company if, amongst other things, the company is, or is likely to become, unable to meet its policy or other liabilities as they become due); and

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(ii) having regard to the results of the investigation by APRA, it is in the interests of the owners of policies issued by the life company that the order be made;

(b) that the time needed to complete an investigation by APRA would be likely to prejudice the interest of the owners of policies issued by the company; and

(c) any of the following apply:

(i) the company is, or is likely to become, unable to meet its policy or other liabilities as they become due;

(ii) the company has failed the solvency standard prescribed by the prudential standards;

(iii) the company has failed to comply with a direction given by APRA under section 230B of the *Life Insurance Act* (this section broadly empowers APRA to give a company such written directions as are reasonably necessary to ensure as far as practicable, that the company will be able to meet all policies and other liabilities out of the assets of the statutory fund as they become due); or

(iv) there are reasonable grounds to believe that the financial position or management of the company may be unsatisfactory.

The judicial management of a life company (or part of the business of a life company) commences at the time specified in the order as the time at which the judicial management is to commence, or if no time is specified, when the order is made. Judicial management terminates on the occurrence of certain specified events including the winding up of the life company.

While a judicial manager is appointed to a life company (or part of the business of a life company) the management of the life company (or the management of the relevant business) vests in the judicial manager appointed by the Australian Court.

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While a life company (or part of the business of a life company) is under judicial management, a proceeding in a court against the company or in relation to its property cannot be commenced or proceeded with, without the judicial manager's written consent, or with the leave of the court.[103]

The appointment of a judicial manager under the *Life Insurance Act* is explicitly within the definition of "external administration" under the *Netting Act* where a person, or part of the person's business, comes under judicial management under the *Life Insurance Act*. However, the impact of a party's ability to close out Covered Transactions relating to, or enforcing security under, a Covered Base Agreement or CDA of:

(A) the appointment of a judicial manager; or

(B) the judicial manager doing an act to facilitate recapitalisation,

is considered in detail in paragraph B.2.8 and Schedule 4 to this memorandum.

A judicial manager may recommend and apply to the court for the winding up of the life company if, in its opinion, that is most advantageous to the general interest of the policy owners while promoting financial system stability in Australia. The court may then make an order to wind up the life company if it is satisfied that this is most advantageous to the general interest of the policy owners. APRA also is entitled to apply for an order that a life company be wound up if, as a result of an investigation under Division 3 of Part 7 of the *Life Insurance Act*, it is satisfied that it is necessary or proper. The court may then make an order to wind up the life company it if is satisfied that it is in the interests of the owners of policies issued by the life company.

Section 187 of the *Life Insurance Act* contains specific provisions dealing with the application of assets of a statutory fund in the winding up of the life company. However, we consider that this does not override the application of the *Netting Act* because the *Netting Act* expressly provides that it is to take effect "despite any other law" including section 187 of the *Life Insurance Act*.

[103] Although this does not apply to a proceeding in respect of an offence or a contravention of a provision of a law for which a pecuniary penalty (however described) may be imposed.

7. Appointment of a judicial manager in respect of a general insurer

The process of appointing a judicial manager to a general insurer under the *Insurance Act* is broadly modelled on the judicial management arrangements in place for life companies described above.

As above, the appointment of a judicial manager under the Insurance Act is explicitly within the definition of "external administration" under the *Netting Act* where a person comes under judicial management under the *Insurance Act*. However, and as above, the effect of the appointment of a judicial manager to a general insurer is similar to that outlined above in respect of appointment of a judicial manager in respect of a life company. Namely:

(a) while a general insurer is under judicial management, a proceeding in a court against the general insurer or in relation to any of its property cannot be commenced or proceeded with, except with the judicial manager's written consent or leave of the court;[104]

(b) if the general insurer is party to a contract (including a *Master Agreement*):

(i) the appointment of a judicial manager; and

(ii) that the judicial manager does an act to facilitate recapitalisation (within its specific powers),

are "specified stay provisions" to which the *Netting Act* protection is subject.[105] The effect of these provisions is considered in detail in paragraph B.2.8 and Schedule 4 to this memorandum.

[104] Although this does not apply to a proceeding in respect of an offence or a contravention of a provision of a law for which a pecuniary penalty (however described) may be imposed.

[105] The note in the legislation states that before doing such an act, the judicial manager will usually need to get and consider a report on the fair value of each share or right concerned, and will need to report to the relevant *Australian court* and obtain the court's order for the act.

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8. Appointment of an acting trustee to an Australian superannuation entity under the *SIS Act*

This applies to a trustee which is an Australian Company and trustee of a superannuation entity subject to the *SIS Act*.

Under the *SIS Act*, with the written consent of the Minister, APRA can suspend or remove the trustee (or all of the trustees) of a superannuation entity if, relevantly:

(a) the trustee, or any of the trustees, is a disqualified person pursuant to Part 15 of the *SIS Act* (because, for example, a receiver, administrator or provisional liquidator has been appointed to it);

(b) it appears to APRA that conduct that has been, is being, or is proposed to be, engaged in by the trustee or any other trustees of the entity may result in the financial position of the entity or of any other superannuation entity becoming unsatisfactory; or

(c) if the trustee is a trustee of a registrable[106] superannuation entity, the trustee is not an RSE licensee or a member of a group of individuals that is an RSE licensee; or

(d) if the trustee is an RSE licensee, the RSE licensee breaches any of the conditions of its RSE licence.

If APRA suspends all of the trustees of a superannuation entity, then it must appoint a constitutional corporation[107] or an individual to act as the trustee during the period of the suspension. If APRA removes all of the trustees of a superannuation entity, then it must appoint a constitutional corporation or an individual to act as the trustee until the vacancy in the position of trustee is filled. The trustee appointed in either of these circumstances is called the "acting trustee".

[106] A self-managed superannuation fund is not a registrable superannuation entity.

[107] A constitutional corporation is defined as a "foreign corporation" or a "trading or financial corporation formed within the limits of the Commonwealth". The use of "Commonwealth" in this context should not be confused with the Commonwealth of Nations of which Queen Elizabeth II is head.

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If a person is appointed as acting trustee, APRA must make a written order vesting the property of the superannuation entity concerned in the acting trustee. Subject to such property vesting orders, an acting trustee may exercise all of the rights, title and powers and must perform all of the functions and duties of the trustee. The superannuation entity's governing rules, the *SIS Act* and regulations under it and any other law apply to the acting trustee as if that person were the trustee of the superannuation entity.

APRA may terminate the appointment of an acting trustee at any time.

We think that the appointment of an acting trustee under the *SIS Act* falls within paragraph (c) of the definition of "external administration" under the *Netting Act* where the acting trustee is appointed because the trustee of the superannuation entity is, or is likely to become, insolvent. However, if an acting trustee is appointed for other reasons and the trustee of the superannuation entity is not insolvent, or likely to become insolvent, the *Netting Act* would not apply.[108]

If a person is appointed as acting trustee, then APRA may, by legislative instrument, formulate a scheme for the winding up or dissolution, or both, of the superannuation entity under section 142 of the *SIS Act*. However, we consider that this does not override the operation of section 14(2) of the *Netting Act* because section 14(3) of the *Netting Act* expressly provides that it is to take effect "despite any other law" including the "specified provisions," which includes section 142 of the *SIS Act*.

SCHEDULE 3

Summary of the *Netting Act*

The *Netting Act* was enacted to remove certain legal doubts as to the efficacy of netting operations under the law of the Australian Jurisdictions. In addition to close-out netting, the *Netting Act* validates certain market

[108] An enquiry needs to be made of APRA to find out whether an acting trustee has been appointed because the trustee of the superannuation entity is insolvent or likely to become insolvent. However it would be reasonable to expect that there would be publicity attached to such an appointment.

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netting contracts, approved real time gross settlement payment systems and the existing multi-lateral netting arrangements used by Australian clearing banks.

In this memorandum, we are only concerned with the effect of Part 4 of the *Netting Act*, which deals with "close-out netting contracts".

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

The *Netting Act* defines a "close-out netting contract" as follows:

> "(a) a contract under which, if a particular event happens:
>
> (i) particular obligations of the parties terminate or may be terminated; and
>
> (ii) the termination values of the obligations are calculated or may be calculated; and
>
> (iii) the termination values are netted, or may be netted, so that only a net cash amount (whether in Australian currency or some other currency) is payable; or
>
> (b) a contract declared by the regulations to be a close-out netting contract for the purposes of this Act;
>
> but does not include:
>
> (c) a contract that constitutes, or is part of, an approved netting arrangement; or
>
> (d) a contract in relation to which a declaration under section 15 is in force; or
>
> (e) a contract declared by the regulations to not be a close-out netting contract for the purposes of this Act."

Subsection (c) is designed to prevent overlap with other sections of the *Netting Act* dealing with netting arrangements used by Australian clearing banks and approved by the Reserve Bank of Australia. These other sections are inapplicable to the Covered Base Agreements and CDAs. Subsections (d)

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and (e) are designed to provide a mechanism for specific contracts to be excluded either by a declaration by the Reserve Bank of Australia (on the basis of risk of systemic disruption) or by regulation passed under the *Netting Act*. After inquiry we are not aware of any such declarations or regulations.[109]

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

Section 14(1) of the *Netting Act*, which deals with the operation of close-out netting prior to external administration, applies only if, relevantly, Australian law governs the "close-out netting contract".

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

Section 14(2)(c) of the *Netting Act* provides that, in respect of a "close-out netting contract", where a party goes into "external administration":

(a) obligations under a "close-out netting contract" may be terminated;

(b) termination values may be calculated; and

(c) a net amount become payable,

in accordance with the 'close-out netting contract'.

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

(a) *they become a body corporate that is a Chapter 5 body corporate within the meaning of the [Corporations Act]; or*

(b) *they become an individual who is an insolvent under administration; or*

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

[109] In addition, the *1998 Explanatory Memorandum* provides that: "It is envisaged that the Reserve Bank would make a declaration under [section] 15 in only the most exceptional circumstances".

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(d) *an ADI statutory manager takes control of the person's business under the [Banking Act]; or*

(e) *the person comes under judicial management under the [Insurance Act]; or*

(f) *the person, or a part of the person's business, comes under judicial management under the [Life Insurance Act].*"

Each of the insolvency proceedings described in Schedule 2 to this memorandum fall within the definition of "external administration" in the *Netting Act*. Each of these proceedings is also governed by Australian law. As a result section 14(2) of the *Netting Act* is applicable on the occurrence of each of these proceedings.

In addition, subsections 14(2)(d) to (f) of the *Netting Act* provide that:

(i) obligations that are, or have been, netted or terminated under the 'close-out netting contract' are to be disregarded in the external administration;

(ii) any net obligation owed by the party under the 'close-out netting contract' that has not been discharged is provable in the external administration; and

(iii) any net obligation owed to the party under the 'close-out netting contract' that has not been discharged may be recovered by the external administrator for the benefit of creditors.

In addition, section 14(2)(g) of the *Netting Act* provides that:

(A) the netting or termination of obligations under the close-out netting contract;

(B) a payment made by the party to discharge a net obligation under the close-out netting contract; and

(C) the enforcement of security under paragraph 14(2)(fa);

are not to be void or voidable in the external administration into which the person who is a party to the close-out netting contract has gone.

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4 Constitutional reach of the *Netting Act*

The Commonwealth of Australia is a federation of the various Australian States and Territories. The power of the Commonwealth government (as opposed to the State governments) is limited by reference to specific heads of power in the Constitution of Australia. Section 14 of the *Netting Act* was drafted with the intention that it only applies to "close-out netting contracts" which can be regulated pursuant to the Commonwealth's constitutional power.

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

(a) Australian law governs the "close-out netting contract"; or

(b) Australian law governs the external administration.

The circumstances in which Australian law governs an external administration of an Australian Company are described in Schedule 2 to this memorandum. As we have assumed New York Law governs the Covered Base Agreements and CDAs the application of the Netting Act to the external administration of an Australian Company will depend upon the external administration being governed by Australian law.

5 Application of the *Netting Act*

There is a technical argument that the *Netting Act* will not be effective where its operation purports to deprive a person of property other than on just terms (because of section 51(xxxi) of the Constitution of the Commonwealth of Australia). This could be the case where a third party has taken a valid interest in an obligation owing under the "close-out netting contract" and the *Netting Act* has the effect of terminating that obligation and, as a result, the third party's interest.

However, for the netting conducted under the *Netting Act* to be considered to be depriving a third party of an interest in an obligation it is necessary that either:

(a) the creation of the interest in the obligation was not prohibited by a "close-out netting contract" itself. This is because such a prohibition would be effective in preventing a valid

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interest being taken. The loss of an invalid interest would not be considered the deprivation of property; or

(b) the party which owes the obligation has received notice of the interest of the third party. This is because a third party taking an interest in an obligation is subject to any equities (such as rights to set-off or net) owed to the other party in connection with the obligation which are created prior to the other party receiving notice of the existence of the third party's interest.

Accordingly, if third parties taking an interest in the obligations being netted under the Contractual Set-off Right is prohibited, then we consider the technical argument specified above cannot apply. Nor do we consider that it can apply to Contractual Set-off Rights which were created after the *Netting Act* became effective (being 2 July 1998).

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

6.1 *Section 14(4)*

Under section 14(4), a person may not rely on the application of section 14(2) to a right or obligation under a close-out netting contract if:

1.6 Circumstances affecting the protection

If security is given over financial property, in respect of obligations to a party to a close-out netting contract, then there are some limitations on the protections afforded to the enforcement of the security under the Netting Act. These limitations apply in relation to rights and obligations under the security in the same way as they apply in relation to rights and obligations under the close-out netting contract.[144]

The FCM may not rely on the protections afforded to the enforcement of security under the Netting Act in either of the following two scenarios:

[144] Section 14(9) of the Netting Act.

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(a) the following two circumstances exist:

(i) (a)the person acquired the right or obligation from another person with notice at the time of "acquiring"[145] the right or obligation from another person, the person has notice of the fact that that other person, or the other party to the contract, was at theat time unable to pay their debts as and when they became due and payable; and

(ii) (b)the person acquired the right or obligation otherwise than as a result of the operation of section 22, 35 or 36R of the *Financial Sector (Business Transfer and Group Restructure) Act 1999* (Cth) ("**Business Transfer Act**").;[146] or

(b) the following circumstances exist:

The expression "acquiring" in the context of a transaction is intended to mean both obtained by grant or creation and by transfer.[110]

Accordingly, any profit or loss arising in respect of a transaction acquired by a solvent party at a time when the solvent party had notice of the insolvent party's insolvency will not be permitted to be netted against profits and losses under other transactions.

6.2 *Section 14(5)*

Section 14(5) of the *Netting Act* provides that section 14(2) of the *Netting Act* does not apply to an obligation owed by a party to a close-out netting contract to another person if:

(i) (a)the party goes into external administration;and

(ii) (b)the party acquired the obligation otherwise than as a result of the operation of section 22, 35 or 36R of the Business Transfer Act; and

[145] The 2016 Explanatory Memorandum explains that the term "acquired" is intended to mean both obtained by grant or creation and by transfer: [1.174].

[146] Section 14(4) of the Netting Act.

[110] *2016 Explanatory Memorandum*, [1.174].

(c) section 14(6) of the *Netting Act* is satisfied.

(iii) Section 14(6) is satisfied if any of the following are satisfied:

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

(A) (ii)when that transaction was entered into, the other person had reasonable grounds for suspecting that the party was insolvent at that time or would become insolvent because of, or because of matters including:

- (A)entering into the transaction; or
- (B)doing an act, or making an omission, for the purposes of giving effect to the transaction; or

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

It follows that it is important for a party seeking to rely on the Futures Liquidation Rights, Futures Netting Rights, Cleared Derivatives Liquidation Rights, Cleared Derivatives Netting Rights, and rights relating to the enforcement of security, that it:

(A) enters into each transaction in good faith. Good faith would be absent if there were fraud or if there subsisted an intention on the part of the party to obtain an advantage vis a vis the other creditors of the Australian Company. A transaction entered into as part of the ordinary course of business would not of itself result in the inference that there was an absence of good faith;

(B) at the time when it became a party to the transaction, the party had no reasonable grounds for suspecting that the Australian Company was insolvent (in the sense that the Australian Company was unable to pay all its debts as and when they become due and payable) or would become insolvent if it entered into the transaction. The notion "reasonable grounds for suspecting" embodies something which, in all the circumstances, would create in the mind of a reasonable person in the position of the party (as payee) an actual apprehension or fear that the Australian Company was unable to pay its debts when they became due and

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payable. The notion also embodies a mistrust of the Australian Company's ability to pay its debts as they become due, and an appreciation of the advantage which the party's acceptance of the payment would have as between the party and other creditors of the Australian Company; and

(C) provided valuable consideration under the transaction or changed its position in reliance on the transaction. In this context, the valuable consideration must be real and not colourable, in the sense of being contrived or without substance. In our view, the incurrence of the mutual obligations of each party to a transaction to make payments or deliveries would constitute valuable consideration for these purposes.

6.4 *Application of subsections 14(4) and 14(5) of the Netting Act to security arrangements*

If security is given over financial property, in respect of obligations of a party to a close-out netting contract, then the subsections 14(4) and 14(5) of the *Netting Act* as described above each applies in relation to rights and obligations under the security (or an obligation owed by a party to the security) in the same way as it applies in relation to rights and obligations under (or an obligation owed by a party to) the contract.[111]

SCHEDULE 4

New framework for stays on close-out rights

1 Stays in the Banking Act, Business Transfer Act, Insurance Act, and the Life Insurance Act ("Industry Acts")

1.7 Manner of enforcement to comply with applicable law

The Netting Act protection of enforcement of security only applies to the extent that the enforcement of security is carried out in a manner that complies with section 420A of the Corporations Act (if it applies) and any applicable general law duties that are not inconsistent with the terms of the

[111] Section 14(9) of the *Netting Act*.

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security.[147] Some of these duties are considered in paragraph 2.1 of Part G. The 2016 Explanatory Memorandum also provides that:

> "Whilst the security may be enforced in accordance with the terms of the security, the protections provided to the enforcement of security under sections 14(1) and 14(2) would not apply to the extent the terms of the security purported to allow a secured person to appropriate or sell financial property at zero, or nominal, value as the enforcement would not reflect any attempt to calculate, or value, the financial property in good faith or in a commercially reasonable manner."[148]

The 2016 Explanatory Memorandum provides that the reforms to the Netting Act which protect the enforcement of security in accordance with the Netting Act (including the provisions relating to possession and control) should not be interpreted as limiting or otherwise restricting anything which would otherwise be available or protected at law (including any rights which a secured party would otherwise have by virtue of the PPSA, the exercise of those rights and any protection which applies to those rights or the exercise of those rights).[149]

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[147] 2016 Explanatory Memorandum, [1.159], which also states that, for example, "the duties to which controllers are subject under Part 5.2 of the Corporations Act (e.g. section 420A regarding the controller's duty of care in exercising power of sale) may still apply" (footnote omitted). See also 2016 Explanatory Memorandum, [1.168]–[1.169] which states:

> "[I]f another law purported to prevent enforcement of the security in accordance with its terms, it would be inconsistent and must yield. Similarly, if any other law purported to impose conditions that must be satisfied before the security can be enforced, that other law would also be inconsistent and must yield…
>
> However, another law which purported to regulate the manner in which the security is enforced (for example, section 420A of the Corporations Act, if it applied, as described above) would continue to apply provided that it only impacted the way in which the secured person need to enforce its security and did not in any way inhibit the actual enforcement of security".

[148] 2016 Explanatory Memorandum, [1.160].

[149] 2016 Explanatory Memorandum, [1.109].

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SCHEDULE 4

FRAMEWORK FOR STAYS ON CLOSE-OUT RIGHTS

0 Stays in the Industry Acts

In 2016, the Collateral Protection Act amended a number of stays which may apply to an Australian Company ~~that is an ADI, life company or general insurer~~ under the Industry Acts. The stays framework in the Industry Acts was further amended by the *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Act 2018* (Cth) in March 2018.

The amended stays have the effect that none of the following ~~things do not~~ matters allow a contract to which a ~~regulated~~ body corporate[150] is a party, or a counterparty to the contract, to deny any obligations under that contract, accelerate any debt under that contract, close out any transaction relating to that contract or enforce any security under that contract:~~(a)~~

(a) the ~~fact that the~~ body corporate ~~relevant~~ or member ~~regulated body is subject to~~ of the corporate group[151] being given a direction by APRA under the relevant ~~provisions~~ sections of the Industry Acts;~~113~~[152]

(b) ~~(b)the fact that the relevant regulated body is~~ the body corporate or member of the corporate group being subject to a recapitalisation direction~~,~~[~~114~~,153]

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[150] Or, in the case of paragraph 1(c) of Part J below, the "conversion entity" for a relevant capital instrument which is converted, being the entity whose ordinary shares or mutual equity interests the instrument is converted into in accordance with the terms of the instrument.

[151] For the purposes of the Industry Acts, a regulated body and its subsidiaries together constitute a "relevant group of bodies corporate" and a NOHC and its subsidiaries together also constitute a "relevant group of bodies corporate". References in this opinion to a "member of the corporate group" in respect of a body corporate refer to any member of such a group of which the relevant body corporate is a member.

~~113~~[152] See, relevantly, section 11CD(1A) of the Banking Act, section 105(1A) of the Insurance Act and section 230C(1A) of the Life Insurance Act.

~~114 See section 13N(2) of the *Banking Act*, section 103K(2) of the *Insurance Act* and section 230AJ(2) of the *Life Insurance Act*.~~

[153] See section 13N(2) of the Banking Act, section 103K(2) of the Insurance Act and section 230AJ(2) of the Life Insurance Act.

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(c) certain capital instruments issued by the body corporate or member of the corporate group, or to which such entity is a party or for which it is a conversion entity, being converted or written off, or APRA making a determination that results in the instrument being required to be converted or written off, in each case, in accordance with the terms of the relevant instrument,[154]

(together, the stays in paragraphs 1(a(a) and 1(bto (c) immediately above are defined in the Netting Act as the "direction stay provisions" and are referred to in this memorandum opinion as "**direction stays**");;

(d) (c)the appointment of a statutory manager or the appointment of a judicial manager to the body corporate or a member of the corporate group (or, in the case of the appointment of a judicial manager to a Life Company, part of its business), or the Federal Court making an order for the appointment of such a judicial manager;[115155]

(e) (d)the fact that a statutory manager or judicial manager of the regulated body does body corporate or member of the corporate group doing certain acts to facilitate recapitalisation;[116156] and

(f) (e)the fact that an act is being done for the purposes of Division 2 or 3 of Part 4 of the Business Transfer Act, or that a certificate of transfer comesing into force under Division 3 of Part 4 of the Business Transfer Act, in connection with a regulated body corporate or member of the corporate group,[117157]

(together, the stays in paragraphs 1(c(d) to 1(e(f) immediately above are referred to in this memorandum opinion as "**non-direction stays**").

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[154] See section 11CAC(2) of the Banking Act, section 36C(2) of the Insurance Act and section 230AAD(2) of the Life Insurance Act.

[115155] See section 15C(2) of the Banking Act, sections 62V(2) and 62ZOX(2) of the Insurance Act and sections 165B(2) and 179AX(2) of the Life Insurance Act.

[116156] See section 14AC(2) of the Banking Act, sections 62ZB(2) and 62ZOH(2) of the Insurance Act and sections 168C(2) and 179AH(2) of the Life Insurance Act.

[117157] See section 36AA(2) of the Business Transfer Act. Subject to the manner in which stays cease under the Netting Act, the stay under section 36AA(2) of the Business Transfer Act applies if a body corporate that is, or is proposed to become, a transferring body (as defined under the Business Transfer Act) is or was party to a contract.

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Each of the stays referred to above (including both the direction stays and the non-direction stays) is defined in the Netting Act as a "specified stay provision".

If it applies, the Netting Act provides that: (i) obligations may be terminated, termination values may be calculated and a net amount become payable in accordance with the close-out netting contract ; and(ii)security given over financial property, in respect of obligations of a party to the contract, may be enforced in accordance with the terms of the security, provided the terms of the security are evidenced in writing (but see section 14A), "despite any other law" (including the specified provisions),[118][158] subject to any specified stay provision that applies to the contract or security (as applicable).

However, even if one or more of these stays apply, a specified stay provision should not prevent a party counterparty to a contract from exercising any rights under that contract which do not involve the denial of obligations, the acceleration of any debt, the closing out of any transaction or the enforcement of any security. interest. For example, a specified stay provision should not prevent a party exercising a right to call for additional margin from the body corporate in accordance with the contract assuming that the exercise of such a right does not involve any of these things.

Please see paragraph 4 of this Part below regarding the stays framework that applies in the case of a transfer under the Business Transfer Act.

See also paragraph 3.4 of this Schedule below for our commentary in relation to closing out transactions for any other reason.

[118][158] Section 14(3) of the Netting Act. Section 14(9) of the The Netting Act provides that if security is given over financial property, in respect of obligations of a party to a close-out netting contract, then subsection (3) applies in relation also clarifies the way in which these stays interact with the protections otherwise provided to the enforcement of security in the same way as it applies in relation to . However, this is beyond the contractscope of this opinion.

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1 Direction stays

1.1 2.1 Direction stays do not cease

Direction stays are not subject to the provisions under the Netting Act that now set out the circumstances in which non-direction stays may cease and are considered in paragraphs 3.1 to 3.3 below. Accordingly, the direction stays apply permanently.

Therefore, if a direction stay applies, a counterparty would not be able to close out any transaction relating to, or enforce any security under, that contract on the grounds of the direction by APRA or , the recapitalisation direction or the conversion or write-off of the relevant capital instrument or APRA making a determination that results in the instrument being required to be converted or written off. However, see paragraph 3.4 below for our commentary in relation to closing out transactions, or enforcing any security, for any other reason.

2 Non-direction stays

2.1 3.1 Circumstances in which non-direction stays may cease

The Netting Act now sets out the circumstances in which non-direction stays may cease.

The *Netting Act* provides that a A non-direction stay may cease in accordance with particular provisions in relation to (i) a *close-out netting contract* to which an ADI, life company or a general insurer is a party, or (ii) a security given over financial property, in respect of an obligation of a party to a close-out netting contract to which an ADI, life company or a general insurer is a party, if: a Regulated Body or a related body corporate[159] of a Regulated Body is a party, if:

(a) (a) an obligation under the contract of a party to the contract is:

(i) (i) an "eligible obligation" in relation to the contract; or

(ii) (ii) an obligation of another prescribed kind; and

[159] For the purposes of the Netting Act, the question whether a body corporate is related to another body corporate is to be determined in the same way as that question is determined for the purposes of the Corporations Act.

(b) (b)a non-direction stay applies to a trigger event[119][160] that happens in relation to the contract.

Eligible obligation in relation to the contract

Under the Netting Act an obligation is an "eligible obligation" in relation to a close-out netting contract if the obligation is any of the following:

(i(A)) an obligation under the contract of a party to the contract that relates to a derivative[120][161] or foreign exchange contract[121][162] or is of another prescribed kind;[122][163]

(iiB) an obligation that results from the netting of two or more obligations that are created under the contract that:

(i) (A)must include at least one obligation covered by paragraph (iA) above; and

(ii) (B)may include one or more incidental obligations that, taken together, do not form a material part of the net obligation; or

(iii(C)) an obligation declared by the Netting Regulations to be an eligible obligation in relation to a close-out netting contract.[123][164]

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[119][160] A "trigger event" for a close-out netting contract is defined in the Netting Act to mean an event of a kind mentioned in paragraph (a) of the definition of close-out netting contract. Paragraph (a) of that definition provides that "a contract under which, if a particular event happens: (i) particular obligations of the parties terminate or may be terminated; and (ii) the termination values of the obligations are calculated or may be calculated; and (iii) the termination values are netted, or may be netted, so that only a net cash amount (whether in Australian currency or some other currency) is payable". Simply, a trigger event is an event which gives rise to a close-out right under the relevant close-out netting contract.

[120][161] The term "derivative" in the Netting Act has the same meaning as in Chapter 7 of the Corporations Act.

[121][162] The term "foreign exchange contract" in the Netting Act has the same meaning as in Chapter 7 of the Corporations Act.

[122][163] In this regard, the *Financial System Legislation Amendment (Resilience and Collateral Protection) Regulation 2016* (Cth) amended the Netting Regulations to prescribe as an eligible obligation an obligation that relates to an arrangement that is a forward, swap or option, or any combination of those things, in relation to one or more commodities.

[123][164] As at the date of this memorandumopinion, no such declaration has been made.

However, an obligation is not an eligible obligation in relation to a close-out netting contract if it is declared by the Netting Regulations not to be an eligible obligation in relation to the contract for the purposes of the Netting Act.~~124~~165

Obligation of another prescribed kind

An obligation of a party to a close-out netting contract to which ~~an ADI, a life company or a general insurer~~ a Regulated Body is a party is a "prescribed obligation" for the purposes of the provisions related to the ceasing of non-direction stays, if the obligation is ~~created~~ under a reciprocal purchase agreement (otherwise known as a repurchase agreement), a sell-buyback arrangement or a securities loan arrangement.~~125~~166

~~124~~165 Under the Netting Regulations, each of the following obligations have also been declared not to be an eligible obligation:

(a) an obligation under a credit facility (which has meaning given in the regulations made for the purposes of subparagraph 765A(1)(h)(i) of the Corporations Act), including:

(i) a margin lending facility which has the meaning given in Chapter 7 of the Corporations Act; and

(ii) an obligation under a financial product that is declared by the Australian Securities and Investments Commission under section 761EA(9) of the Corporations Act not to be a margin lending facility;

(b) an obligation under a deposit-taking facility;

(c) an obligation under a contract of insurance, including a life policy or a sinking fund policy within the meaning of the Life Insurance Act;

(d) an obligation under a managed investment scheme (which has the meaning given in the Corporations Act);

(e) an obligation under a lease or licence;

(f) an obligation under a guarantee;

(g) an obligation to pay money under a cheque, an order for the payment of money or a bill of exchange; and

(h) an obligation under a reciprocal purchase agreement (otherwise known as a repurchase agreement), a sell-buyback arrangement or securities loan arrangement.

However, we note that the obligations referred to in paragraph (h) of this footnote are obligations of a prescribed kind for the purposes of section 15A(1) of the Netting Act, as considered in this paragraph. As a result, the carve-out of obligations referred to in paragraph (h) from the definition of "eligible obligations" is not relevant to this ~~memorandum~~opinion.

~~125~~166 Regulation 7 of the Netting Regulations. As noted in the paragraph above, an obligation under a reciprocal purchase agreement (otherwise known as a repurchase agreement), a sell-buyback arrangement or a securities loan arrangement is excluded from the definition of "eligible obligation". However, see Part G in respect of enforcement of the FCM's Security Interest in Covered Collateral.

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2.2 3.2When non-direction stays cease

A non-direction stay ceases to apply to a close-out netting contract, or a security given over financial property, in respect of an obligation of a party to a close-out netting contract, to which a regulated body is a party:

(a) (a)at the time when a particular declaration made by APRA (namely, that the non-direction stay is to cease) takes effect in relation to the contract or security; or

(b) (b)at the end of the "resolution period" for the trigger event, if no declaration has been made by APRA extending the non-direction stay in relation to the contract or security during that period.

With respect to paragraph 3.2(a) above, APRA will may make such a declaration if APRA is satisfied that APRA it will not make a declaration extending the non-direction stay in relation to a party before the end of the resolution period for the trigger event.

APRA may, before the end of the resolution period for the trigger event, declare that the non-direction stay is to cease to apply to, relevantly, all close-out netting contracts of the party and all securities given over financial property in respect of obligations of the party under all close-out netting contracts of the party.

With respect to paragraph 3.2(b) above, the "resolution period" for a trigger event begins when the relevant trigger event happens and ends

:(A) for the non-direction stay related to compulsory transfers of business under the *Business Transfer Act*, just after the certificate of transfer comes into force (if a certificate comes into force) or at the time declared by APRA (which may be made if, relevantly, APRA is satisfied that it will not issue a certificate of transfer under the *Business Transfer Act*); and

(B)for the other non-direction stays (ie those related to statutory management, judicial management and recapitalisation activities), at midnight (by legal time in the Australian Capital Territory) at the end of the first business day after the day on which the trigger event happens.

At the end of the relevant resolution period, the non-direction stay ceases to apply provided that APRA has not made a declaration extending the stay beyond the resolution period, as considered below.

2.3 ~~3.3~~**Permanent non-direction stay only if APRA declares satisfaction of solvency- and licensing-related matters**

A non-direction stay may continue to apply permanently if APRA makes a declaration extending the stay.

Relevantly ~~for this memorandum~~, where a trigger event to which a non-direction stay applies is an event that involves a Regulated Body (being the "**trigger body**"), such a declaration may be made in respect of~~:~~ close-out netting contracts to which either the trigger body, or a related body corporate of the trigger body, is a party.

~~(a) an ADI, life company or general insurer; or~~

~~(b) if, under the *Business Transfer Act*, a certificate of transfer will come into force for:~~

~~(i) a total transfer, the receiving body (as defined in the *Business Transfer Act*); or~~

~~(ii) a partial transfer, either or both of the transferring body (as defined in the *Business Transfer Act*) or receiving body.~~

APRA may only make the declaration if, relevantly:

(a) ~~(i)~~APRA is satisfied that certain solvency- and ~~licensing-~~ licensing-related matters (considered below) will be satisfied in relation to the ~~pa~~trty ~~in~~ gger ~~espect of which~~ body at the time the declaration will be made~~:~~;

~~(i) if a certificate of transfer will come into force under the *Business Transfer Act*, just after that coming into force; or~~

~~(ii) in all other cases, at the time the declaration will be made;~~

(b) ~~(ii)the party in respect of which the declaration will be made~~ the trigger body is not in external administration (other than statutory management or judicial management); and

(c) (iii)APRA has not already made a declaration that the non-direction stay ceases to apply in relation to the trigger event happening in relation to the contract.[126][167]

If the conditions referred to in (ia), (iib) and (iiic) above are satisfied, then APRA may, before the end of the resolution period for the trigger event, declare that the non-direction stay is to continue to apply to, relevantly:

- (A)if a certificate of transfer for a total transfer will come into force under the *Business Transfer Act*, all close-out netting contracts to which the receiving body (within the meaning of the *Business Transfer Act*) will become trigger body is a party and all securities given over financial property, in respect of obligations under those close-out netting contracts; or

(B) if a certificate of transfer for a partial transfer will come into force under the *Business Transfer Act*, either or both of the following:

- (i)all each close-out netting contracts to which the transferring a related body corporate of the trigger body is a party, that is specified in the declaration and all securities given over financial property, in respect of obligations under those contracts;close-out netting contracts. APRA may specify in the declaration either or both of (i) one or more such contracts; and (ii) one or more classes of such contracts.

(ii) all close-out netting contracts to which the receiving body will become a party, and all securities given over financial property in respect of obligations under those contracts; or

(C) in all other cases, all close-out netting contracts to which the regulated body is a party and all securities given over financial property, in respect of obligations under those close-out netting contracts.

[126][167] The 2016 Explanatory Memorandum explains at [1.232] that this limb is to provide certainty, so that APRA cannot make a declaration extending the application of the relevant stay if it has previously made a declaration that the stay ceases to apply.

The solvency- and ~~licensing-~~ licensing-related matters of which APRA must be satisfied in relation to the trigger body, which are referred to in paragraph ~~(i~~3.3(a) above, are:

- ~~(I)~~that the ~~party~~ trigger body is able to meet all its liabilities under close-out netting contracts to which it is a party and securities given over financial property in respect of obligations of ~~the party~~ it under those contracts as and when they become due and payable;
- ~~(II)~~that the ~~party~~ trigger body is solvent (within the meaning of the Corporations Act);
- ~~(III)that the party~~ if the trigger body is an ADI, General Insurer, Life Company, foreign general insurer or eligible foreign life insurance company, it has each material authorisation (however described) necessary for its regulated business;[~~127~~168] and

~~(IV) either:~~

- if minimum capital requirements under the Banking Act, the Insurance Act or the Life Insurance Act apply to the trigger body, either:
  - ~~(i)the party's~~ the trigger body's level of capital complies with the minimum capital requirements that apply to it under the Banking Act, the Insurance Act or the Life Insurance Act (as the case requires) and the applicable prudential standards made under the relevant Act; or

~~(ii) each of the following are satisfied:~~

  - both:

[~~127~~168] The 2016 Explanatory Memorandum stated at [1.235] that the term "authorisations" should be interpreted to include any licences (eg an Australian financial services licence) and other authorisations upon which the *regulated body* relies to carry out its regulated business. The term "regulated business" ~~of a regulated body~~ is defined in section 5 of the Netting Act to mean:

- ~~if the body is~~ in relation to an ADI — the ~~body's~~ ADI's banking business (within the meaning of the Banking Act);~~or~~
- ~~if the body is~~ in relation to a general insurer — the ~~body's~~ general insurer's insurance business (within the meaning of the Insurance Act); or
- ~~if the body is~~ in relation to a life company — the ~~body's~~ life company's life insurance business (within the meaning of the Life Insurance Act).

- (A)arrangements are in place to ensure that the ~~party~~ trigger body performs all its obligations under close-out netting contracts to which it is a party and securities given over financial property in respect of obligations of the ~~party~~ trigger body under those contracts as and when they are due to be performed; and
- (B)those arrangements will remain in place until at least the earliest day on which the ~~party~~ trigger body complies with the relevant minimum capital requirements that apply to it, or the statutory management or judicial management comes to an end under the relevant Act.~~128~~169

The 2016 Explanatory Memorandum explained that these requirements:

> "are intended to reflect international developments such as the [ISDA 2015 Universal Resolution] Stay Protocol as closely as possible, particularly the requirements set out in the elements of paragraph (e) of the definition of 'Protocol-eligible Regime' in the Stay Protocol which relates to any 'Close-out Stay' (as that term is defined in the Stay Protocol), whilst also reflecting concepts recognised in Australian law."~~129~~170

If APRA makes a declaration extending the stay, rights to close out transactions ~~or enforce the security~~ due to the relevant trigger event described in the non-direction stay may be permanently stayed.

A regulation-making power is included in the Netting Act with respect to the declaration powers referred to above. The regulation-making power is in substantially the same form for each of these

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~~128~~169 In explaining what would be required to satisfy this requirement, the 2016 Explanatory Memorandum stated at [1.237] that section 15C(5) of the Netting Act is "focussed on the outcome of the arrangements, not the mere fact that assurances or arrangements are in place" and "there must be a high degree of certainty that those arrangements will ensure performance". In listing examples, it was stated that "it is not expected that a guarantee from a commercial guarantor of insufficient creditworthiness would satisfy the requirement" but that the requirement may be satisfied if "the Commonwealth were to provide a guarantee which covered all the regulated body's obligations (including payment and delivery obligations) under close out netting contracts to which it is a party as and when they are due to be performed and which remained in place until at least the earliest day on which the circumstances set out in paragraph 15C(5)(b) occurred".

~~129~~170 2016 Explanatory Memorandum, [1.236].

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declarations. As at the date of this memorandumopinion, no regulations with respect to these declaration powers have been made.

In relation to partial transfers under the *Business Transfer Act*, these may be void if, relevantly:

(aa) a certificate of transfer comes into force in respect of a partial transfer;

(bb) just before the partial transfer, the transferring body is a party to a close-out netting contract or a security given over financial property, in respect of an obligation of the transferring body under a close-out netting contract; and

(cc) the partial transfer covers some (but not all) of:

(i) the assets and liabilities the transferring body has, under the close-out netting contract, with respect to another party to the contract (the "**counterparty**");

(ii) those assets that are property over which security is given in respect of an obligation of the transferring body under the close-out netting contract.

However, the partial transfer is only void:

(i) to the extent of the assets or liabilities the transferring body has, just before the partial transfer, under the close-out netting contract, with respect to the counterparty; and

(ii) if security is given over financial property in respect of an obligation of the transferring body under a close-out netting contract — to the extent that, just before the partial transfer, the assets are financial property in the possession or control of the counterparty or another person (who is not the transferring body) on behalf of the counterparty, under the terms of an arrangement evidenced in writing.[130]

2.4 3.4Close-out for any other reason

The direction stays and non-direction stays only relate to the relevant trigger event described in the specified stay provisions and the framework does not prohibit a party from closing out Covered

[130] Section 36AB of the *Business Transfer Act*.

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Transactions relating to, or enforcing security under, transactions under the close-out netting contract (whether or not an obligation under the contract of a party to the contract is an eligible obligation or an obligation of a prescribed kind) for any other reason. That is to say, a party may, in accordance with the terms of the contract, deny obligations under that contract, accelerate a debt under that contract, close out a transaction relating to that contract or enforce security under that contract where their right to do so arises on the basis of an action other than the appointment of a statutory manager or the appointment of a judicial manager or relevant fact referred to in the other specified stay provisions. For example, a counterparty may still close out transactions relating to, or enforce security under, a close-out netting contract if it has a right to do so in accordance with the contract for any reason other than the appointment of a statutory manager or the appointment of a judicial manager or relevant fact referred to in the other specified stay provisionsclose-out netting contract because the body corporate fails to make a payment or perform an obligation.[131][171] The 2016 Explanatory Memorandum states that:

> "No specified stay provision, including a direction stay provision, has any effect in respect of any other close-out event or trigger for the enforcement of security given in relation to the close-out netting contract happening in relation to the contract or security (e.g. a failure to comply with an obligation under the contract). The stays in the Industry Acts do not prevent a counterparty from closing-out transactions relating to a close-out netting contract or enforcing security on the basis of an action other than the appointment of a statutory or judicial manager or relevant fact referred to in the other specified stay provisions. For example, counterparties may close-out transactions relating to such an arrangement or contract or enforce security because the Regulated Entity or private health insurer is insolvent, or if a Regulated Entity or private health insurer under statutory or judicial management or subject to a direction from APRA (as applicable) fails to satisfy any substantive obligations under a close-out netting contract, market netting contract or security (including any payment and delivery obligations). These other events generally constitute separate events of default which could trigger

[131][171] 2016 Explanatory Memorandum, [1.209].

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the close-out or enforcement rights under the contract, arrangement or security which would be protected under the [Netting Act] notwithstanding the specified stay provisions."[132][172]

2.5 3.5Protection from certain things being void or voidable

The Netting Act also provides that none of the following things done by an ADI, life company or general insurer which is a party to a close-out netting contract, while it is under statutory or judicial management[133][173] and a "specified stay provision" applies to the contract, is to be void or voidable in an external administration:

(a) (a)making a payment, or transferring property, to another person to meet an obligation under the contract;

(b) (b)creating rights or obligations in another person under the contract;

(c) (c)giving any security to another person in relation to the contract;

(d) (d)entering into one or more close-out netting contracts with another person; or

(e) (e)doing of anything mentioned in paragraphs (a) to (c) under a close-out netting contract mentioned in paragraph (d).[134][174]

However, this protection does not apply to a thing mentioned in paragraphs (a) to (e) done by a party to the close-out netting contract in relation to another person if:

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[132][172] 2016 Explanatory Memorandum, [1.202] (footnote omitted).

[133][173] In this context, a person is under statutory or judicial management if: (a) an ADI a Banking Act statutory manager has takes control of the person's business under the Banking Act; or (b) an Insurance Act statutory manager takes control of the person is under judicial management 's business under the Insurance Act; or (c) a Life Insurance Act statutory manager takes control of the person's business under the Life Insurance Act; or (d) the person comes under judicial management under the Insurance Act; or (e) the person, or a part of the person's business, is comes under judicial management under the Life Insurance Act.

[134][174] Section 14(7) of the Netting Act.Section 14(9) of the *Netting Act* provides that if security is given over financial property, in respect of obligations of a party to a close-out netting contract, then subsection (7) applies to things done by a party to the security in relation to the security, or a right or obligation under the security, in the same way as it applies in relation to things done by a party to the contract in relation to the contract, or a right or obligation under the contract.

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() (i)the transaction did not result from the operation of section 22, 35 or 36R of the Business Transfer Act; and

(a) (ii)either of the following is satisfied:

(i) (i)the other person did not act in good faith in entering into the transaction; or

(ii) (ii)the other person neither provided valuable consideration under, nor changed their position in reliance on, the transaction.[135][175]

The definition of "voidable" has been expanded in the *Netting Act*. Accordingly, section Section 5 of the Netting Act provides that an action or thing is voidable in an external administration if it is:

() (A)for an external administration that is a winding up under the Corporations Act — voidable under Division 2 of Part 5.7B of the Corporations Act;or

(a) (B)for an external administration that is a bankruptcy under the *Bankruptcy Act 1966* (Cth) — void as against the trustee in bankruptcy; or

(b) (C)in any other case — void as against the external administrator or voidable under the law governing the external administration.

(a)

SCHEDULE 5

Insolvency set-off

In this Schedule 5, we assume that the Covered Customer is an Australian Company which is either an Australian Bank or is acting in no special capacity.

[135][175] Section 14(8) of the Netting Act.

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~~1 Winding up~~

3 Transfers under the Business Transfer Act

3.1 Effect of stays framework in the case of a transfer

~~Section 553C of the *Corporations Act* permits a right of set-off to apply in the case of mutual credits, mutual debts or other mutual dealings between an insolvent Australian Company that is being wound-up and a creditor who wants to have a debt or claim admitted against that company. Section 553C provides that where there have been "mutual credits, mutual debts and other mutual dealings" between an insolvent company and that creditor then:~~

~~(a) an account is to be taken of what is due from one party to the other in respect of the mutual dealings;~~

~~(b) the sum due from one party must be set-off against the sum due from the other party; and~~

~~(c) only the net balance is payable by or to the liquidator.~~

~~Section 553C is mandatory and self-executing. It operates automatically as at the commencement of winding up to replace the existing obligations of the parties with an obligation to pay a net balance.~~

~~Since it is a mandatory provision, it is not possible to provide contractually that there will be set-off in circumstances not allowed by the section or to exclude a set-off where the law requires it to occur.~~

~~***Requirements for set-off***~~

~~The following requirements must be met for set-off under section 553C to operate:~~

~~*Mutuality between the parties*~~

~~Obligations must be owing between the parties in the same capacities. Mutuality would not exist if parties entered into contracts in different capacities (for example, where some contracts are entered into by a party in its own right and others are entered into by it as trustee or as agent). Nor will mutuality exist if a party has assigned its rights under a contract to another person or granted security or declared a trust over them. Also the mutuality requirement may not be met if an intervener,~~

garnishee order, attachment, or other interest or encumbrance has been created in relation to the right of the party to receive an amount due from the other.

Existence of a claim

Section 553C covers debts existing at the date of commencement of the winding-up of an Australian Company and also debts which arise later out of rights and liabilities existing at that time.

Commensurability

Section 553C only operates to set-off claims that are commensurable. "Commensurability" means that the mutual debts must be capable of being brought together ultimately into a money account, establishing a liability on each side which is pecuniary in nature. Put another way, "commensurable" claims are claims that ultimately are monetary claims which are capable of being set-off.

Circumstances that could affect the availability of set-off

Notice of insolvency

In accordance with section 553C(2), insolvency set-off under section 553C will not apply if, at the time of giving credit to or receiving credit from the insolvent party, the solvent party had notice of the other party's insolvency.

Section 95A of the *Corporations Act* provides that a company which is not solvent is insolvent. A company is solvent if, and only if, it is able to pay its debts as and when they become due and payable. Section 588E of the *Corporations Act* also contains certain presumptions as to insolvency.

Interrelationship between section 13A of the Banking Act and section 553C of the Corporations Act

Where the Covered Customer the subject of winding up is an ADI, section 13A of the *Banking Act* may affect the operation of section 553C of the *Corporations Act*.[136]

[136] The application of section 13A is not limited to ADIs which are being wound up. It applies if an ADI becomes unable to meet its obligations or suspends payment, which could occur at the same time as any insolvency proceeding or if no insolvency proceedings have yet commenced.

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Sections 13A(3) and (4) of the *Banking Act* provide as follows:

"(3) If an ADI becomes unable to meet its obligations or suspends payment, the assets of the ADI in Australia are to be available to meet the ADI's liabilities in the following order:

(a) first, the ADI's liabilities (if any) to APRA because of the rights APRA has against the ADI because of section 16AI;

(b) second, the ADI's debts (if any) to APRA under section 16AO;

(c) third, the ADI's liabilities (if any) in Australia in relation to protected accounts that account-holders keep with the ADI;

(d) fourth, the ADI's debts (if any) to the Reserve Bank;

(e) fifth, the ADI's liabilities (if any) under an industry support contract that is certified under section 11CB;

(f) sixth, the ADI's other liabilities (if any) in the order of their priority apart from this subsection.

Note: Subsection (3) applies whatever other consequences flow from the ADI becoming unable to meet its liabilities or suspending payment (such as investigation of the ADI's affairs, or control of its business, under this Division, or winding up of the ADI).

…

(4) An ADI commits an offence if:

(a) it does not hold assets (excluding goodwill and any assets or other amount excluded by the prudential standards for the purposes of this subsection) in

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Australia of a value that is equal to or greater than the total amount of its deposit liabilities in Australia; and

(b) APRA has not authorised the ADI to hold assets of a lesser value.

Penalty: 200 penalty units.

Note 1: Chapter 2 of the *Criminal Code* sets out the general principles of criminal responsibility.

Note 2: If a body corporate is convicted of an offence against this subsection, subsection 4B(3) of the *Crimes Act 1914* allows a court to impose a fine of up to 5 times the penalty stated above."

Section 13A of the *Banking Act* does not apply if the rights of the Australian Company that are subject to set-off are located outside of Australia. Generally, the situs of a chose in action is the place where it is properly recoverable or may be enforced.[137]

If the rights of the Australian Company that are subject to set-off are located in Australia, then the fundamental issue is whether, where the ADI is being wound up, "assets" in section 13A means the assets of the ADI before section 553C of the *Corporations Act* is applied or the "assets" remaining after section 553C is applied. If the former interpretation is adopted, then, if the right of the insolvent party to receive payment of a gross amount from the solvent party is an asset in Australia, the solvent party would be obliged under section 13A to pay the relevant gross amount to the insolvent party and left to prove for the gross amount payable by the insolvent party.

With respect to the meaning of "assets", when section 13A(3) is read in isolation from section 13A(4) a very strong argument can be mounted that "assets" in section 13A(3) is referring to net assets after the application of section 553C. This is because there is a very similar phrase used in section 501 of the

[26] There is another collateral class called "ADI Account" which is applicable to accounts held in an authorised deposit-taking institution (which is an institution, Australian or not, which is authorised to carry on banking business under the *Banking Act*). However, for technical reasons it should not be applicable to the interest which the grantor of security has in an account which is in the secured party's name and into which money delivered to the secured party is deposited. As we assume that this would be the case, ADI Accounts are not relevant to this memorandum and this memorandum does not address ADI Accounts.

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Corporations Act which states that the "property of a company must, on its winding up, be applied in satisfaction of its liabilities equally". Section 501 must be read in conjunction with section 553C of the *Corporations Act* with the result that it is clear that the phrase "property of a company" in section 501 of the *Corporations Act* means that property existing after the application of the set-off rules in section 553C of the *Corporations Act*. It can then be concluded that there is no inconsistency between section 13A of the *Banking Act* and section 553C of the *Corporations Act*. Section 13A is dealing with priorities in the distribution of assets in the context of an insolvency administration. Section 553C is dealing with what constitutes assets. Therefore, the argument goes, "assets" in section 13A(3) should mean assets remaining after the application of the set-off rules in section 553C.

However, section 13A(4) imposes an obligation on an ADI always to hold assets (other than goodwill and any assets or other amount excluded by the prudential standards for the purposes of this section 13A(4)) in Australia of a value that is equal to or greater than the total amount of its deposit liabilities in Australia. The argument can be made that "assets" in section 13A(3) must have the same meaning as "assets" in section 13A(4), otherwise there would be no point in including section 13A(4) in the legislation. Therefore, the argument goes, since "assets" in section 13A(4) must be measured pre-insolvency without the application of set-off rules, similarly assets in section 13A(3) must be so measured.

These are not the only arguments for, or against, section 553C prevailing over section 13A(3) of the *Banking Act*. Accordingly, it is not possible to be certain about the interaction of sections 13A of the *Banking Act* and 553C of the *Corporations Act*. However, section 13A(3) applies only to assets located in Australia, so the section should not apply if the amount owing to the insolvent ADI is, for Australian conflict of law purposes, located outside of Australia.

As noted above, applicable case law provides that simple contract debts are located and situated in the place in which they are properly recoverable and are properly recoverable where the debtor resides. Further, if a debtor resides in more than one place, the parties may determine the location of the debt by contract. In one case it has been said that:

> "Where a corporation has residence in two or more countries, the debt or chose in action is properly recoverable, and therefore, situated, in that one of those countries where the sum payable is primarily payable, and that is where it is required to be paid by an express or

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implied provision of a contract, or, if there is no such provision, where it would be paid according to the ordinary course of business".[138]

2 Compromise or arrangement with creditors

If the Australian Company and its creditors propose a compromise or arrangement, a contractual set-off right may be exercised by a creditor at any time until the compromise or arrangement binds the creditor. However, the creditor may be unable to exercise its contractual set-off rights once the compromise or arrangement binds the creditor. This will depend upon the terms of the compromise or arrangement.

A proposed compromise or arrangement will bind the creditor only after certain procedural steps have been taken to implement it (including a court application, the convening of meetings of creditors and/or shareholders of the Australian Company, and subsequent court approval).

3 Administration

If the Australian Company is in administration, there are certain restrictions on court proceedings and enforcement processes against the company and its property. However, it has been confirmed by the New South Wales Court of Appeal that a contractual right of set-off may be exercised against a company in administration. As a result, if an Australian Company is put into administration, a contractual set-off right should be able to be exercised.

However, there is one important limitation on contractual set-off rights during an administration. The court also found that any exercise of such rights is subject to the administrator's right of indemnity from the company's assets for the liabilities then incurred by the administrator and the remuneration then owing to the administrator. This could reduce the amount which is available for set-off.

An administration may end with the signing of a deed of company arrangement. Generally, a deed of company arrangement binds all of the creditors of a company in relation to claims arising on or before the date specified in the deed as the date when claims must have arisen to be admissible under the

[138] *Jabbour v Custodian of Israeli Absentee Property* [1954] 1 WLR 138 at 146 (Pearson J).

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deed. Section 553C is taken to be included in a deed of company arrangement unless the deed provides otherwise. As a result, it is arguable that if a company is subject to a deed of company arrangement which does not exclude section 553C, a creditor will not be able to exercise a contractual set-off right in relation to a claim subject to the deed. Instead, set-off under section 553C will apply subject to the requirements set out in paragraph 1 above.

4 Receivership

Receivership is not an insolvency proceeding in the strict sense but rather a remedy for a secured creditor. Accordingly, receivership should be relevant only if the Australian Company has granted security over its rights which are being subject to the set-off. If a receiver is validly appointed over all or some of the Australian Company's assets including its right to the payment which is to be set-off then the operation of the set-off may be affected to the extent of the relevant security.

5 Statutory management

There has been no judicial consideration in the Australian Jurisdictions of whether a contractual right of set-off may be exercised during the statutory management of an ADI.

Analogous reasoning to that applied with respect to the effect of the appointment of an administrator may support the view that, if an ADI is subject to statutory management, a contractual set-off right should be able to be exercised. However, it is likely that the circumstances which gave rise to the appointment of a statutory manager to the ADI may also mean that the depositor protection provisions of section 13A(3) of the *Banking Act* (described in paragraph 1 of this Schedule 5) applies. This may affect the exercise of contractual rights of set-off against the ADI.

In addition, we note that section 15C of the *Banking Act* provides that the fact that a statutory manager is in control of the ADI's business does not allow a contract to which the ADI is a party, or a party to the contract, to deny any obligations under the contract, to accelerate any debt under the contract, close out any transaction relating to that contract or any security under that contract. There is no guidance provided as to whether exercise of a contractual right of set-off is intended to be affected by this provision. However, if a contractual right of set-off were triggered solely by the appointment of a statutory manager, then there is some risk that it could not be exercised.

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~~SCHEDULE 6Competing Claims~~under the Business Transfer Act

The stays framework that applies in the case of a transfer is broadly the same as that summarised in paragraphs 2 and 3 above, subject to the following with respect to non-direction stays:

(a) with respect to when non-direction stays may cease, for the purposes of paragraph 3.2(b) above the "resolution period" with respect to the non-direction stay referred to in paragraph 1(f) above (which relates to certain acts being done, and certificates of transfers coming in effect, under the Business Transfer Act) ends just after the certificate of transfer comes into force;[176] and

(b) with respect to paragraph 3.3 above and a declaration that a non-direction stay is to continue, where a certificate of transfer will come into force under the Business Transfer Act for a transfer of business from a trigger body to a receiving body:

(i) if a related body corporate of the trigger body is a party to the trigger contract, for the purposes of the matters referred to in paragraphs 3.3(a) and 3.3(b) above only, references to the "trigger body" are, in the case of a total transfer of business, to the receiving body, and in the case of a partial transfer of business, are to either or both of the trigger body or the receiving body, as specified in a determination made by APRA;

(ii) APRA must be satisfied that the solvency- and licensing-related matters referred to in paragraph 3.3 above will be satisfied in relation to the trigger body just after that certificate coming into force; and

[176] However, where the trigger event is an act being done for the purposes of Division 2 or 3 of Part 4 of the Business Transfer Act, and APRA is satisfied that it will not issue a certificate of transfer under that Act, APRA may declare that the "resolution period" for that trigger event ends.

(iii) if the conditions referred to in paragraph 3.3 above are satisfied, then APRA may, before the end of the resolution period for the trigger event, declare that the non-direction stay is to continue to apply to:

() in relation to contracts to which a Regulated Body is a party, (I) all close-out netting contracts to which the trigger body is a party, and to which either (aa) it will remain a party immediately after the transfer, or (bb) the receiving body will become a party immediately after the transfer, or (cc) in relation to a partial transfer only, both (aa) and (bb), and (II) all securities given over financial property, in respect of obligations under those close-out netting contracts; and

(A) in relation to contracts to which a related body corporate of the trigger body is a party, each close-out netting contract to which a related body corporate of the trigger body is a party that is specified in the declaration and all securities given over financial property, in respect of obligations under those contracts. APRA may specify in the declaration either or both of (a) one or more such contracts; and (b) one or more classes of such contracts. However, APRA must not make such a declaration, unless it is satisfied that the declaration will not have a detrimental effect on any counterparty to a contract to which the declaration would apply.

The stays framework that applies in the case of a transfer under the Business Transfer Act is complex. In the event of such a transfer, we recommend that separate advice is obtained regarding the effect of a stay.

3.2 Effect of partial transfers under the Business Transfer Act

In relation to partial transfers under the Business Transfer Act, these may be void if, relevantly:

(a) a certificate of transfer comes into force in respect of a partial transfer;

(b) just before the partial transfer, the transferring body is a party to a close-out netting contract or a security given over financial property, in respect of an obligation of the transferring body under a close-out netting contract; and

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(c) the partial transfer covers some (but not all) of:

(i) the assets and liabilities the transferring body has, under the close-out netting contract, with respect to another party to the contract (the "**counterparty**"); and

(ii) those assets that are property over which security is given in respect of an obligation of the transferring body under the close-out netting contract.

However, the partial transfer is only void:

() to the extent of the assets or liabilities the transferring body has, just before the partial transfer, under the close-out netting contract, with respect to the counterparty; and

(a) if security is given over financial property in respect of an obligation of the transferring body under a close-out netting contract — to the extent that, just before the partial transfer, the assets are financial property in the possession or control of the counterparty or another person (who is not the transferring body) on behalf of the counterparty, under the terms of an arrangement evidenced in writing.[177]

The effect of this is that any such purported partial transfer of some, but not all, of the obligations under an agreement would be void.

[177] Section 36AB of the Business Transfer Act.

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SCHEDULE 5
COMPETING CLAIMS

Priority rules

The PPSA includes priority rules which determine the priority between competing security interests attached to the same collateral (and in some cases, they determine priority between a security interest and another interest such as that of a purchaser). These priority rules replace existing common law and equitable rules.

Generally speaking:

(a) a secured creditor has priority over an unsecured creditor;

(b) a perfected security interest has priority over an unperfected security interest;

(c) the first secured party to perfect its security interest has priority;

(d) priority between unperfected security interests is determined by the order of attachment; and

(e) an unperfected security interest vests in a grantor that is a company if an order is made or resolution is passed for its winding up, an administrator is appointed or the company executes a deed of company arrangement.[~~139~~178]

However, there are exceptions, including:

(i) that perfection by control confers greater priority than perfection by registration or possession; and

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[~~139~~178] The time at which this is tested (the "**critical time**") is in the case of a company or body corporate:

(i) that is being wound up, the time when the winding up is taken to have begun or commenced; or

(ii) ~~in any other case,~~ the 'section 513C day' which, in relation to the administration of a company, is the day the administration began or, if ~~a winding up of the company~~ there was ~~in progress~~a prior liquidation, the day when the winding up is taken to have begun.

(ii) that the interest of a judgement creditor has priority over any unperfected security interest at the time when the collateral is seized by or on behalf of the judgement creditor or when the relevant judgement order or garnishee order is made in relation to the judgement creditor.

Taking free rules

The PPSA also includes rules on when personal property can be acquired free of a security interest. Most of the rules apply to a security interest whether or not it is perfected. For example, a purchaser of an investment instrument (other than the secured party) takes the instrument free of a security interest in the instrument if the purchaser gives value for the instrument and the purchaser takes possession or control of the instrument. A similar rule applies in relation to an intermediated security provided that instead of taking possession or control the transferee for value takes its interest in the underlying financial product in accordance with a consensual transaction. Further, if a secured party does not perfect a security interest, a buyer or lessee of the collateral may take the personal property free of the security interest.

Transitional arrangements

The transitional provisions are intended to ensure that transitional security interests which were migrated from existing registers retain the priority they had prior to migration. They do this by providing that the migrated security interest will be taken to be perfected from immediately before 30 January 2012, being the date on which the PPSA commenced operation. Please see paragraph C.II.5.4 1.6 of Part G above with respect to the migration of security interests registered on certain existing registers to the PPS register.

Priority between two or more security interests in collateral that are currently perfected is determined by the order in which the priority time for each security interest occurs. The priority time for a migrated security interest will be the time the security interest is perfected by force of the PPSA. This time will be the time from immediately before the registration commencement time.

All migrated security interests will have the same priority time for the purposes of the priority rules (that is, from immediately before the registration commencement time). This means that all migrated security interests will have priority over any security interests perfected **at or after** the registration commencement time. However, it also means that it will not be possible to determine priority between

two migrated security interests because they have the same priority time. In these circumstances, the PPSA provides that the migrated security interests have the priority between themselves that they would have had under the law that applied to such priority immediately before the registration commencement time and as if the PPSA had not been enacted. In other words, priority will be determined under the priority rules in the Corporations Act that were in force immediately prior to 30 January 2012.~~140~~179

~~140~~179 This is reinforced by sections 1502 and 1506 of the Corporations Act. Section 1502 provides that the repeal of Chapter 2K by the *Personal Property Security (Corporations and Other Amendments) Act 2010* (Cth) does not apply in relation to registrable charges for a period of 7 years after the registration commencement time. Section 1506 further provides that at and after the registration commencement time, registrable charges have the priority between themselves that they would have had under the Corporations Act immediately before the registration commencement time subject to the transitional provisions in the PPSA.

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SCHEDULE ~~7Clawback~~6

STATUTORY AVOIDANCE PROVISIONS

The following paragraphs summarise Australian insolvency laws under which transactions may be void or voidable in certain circumstances, which we refer to as the "**Statutory Avoidance Provisions**".

0 Void dispositions

Section 468 of the Corporations Act renders void any disposition of property of an Australian Company[180] effected after the commencement of the winding up by an Australian court, other than certain exempt dispositions which are not relevant.

Section 437D also renders void any transaction or other dealing affecting the property of an Australian Company under administration, unless the administrator entered into it on the Australian Company's behalf, the administrator consented to it in writing before it was entered into, or it was entered into under an order of an Australian court, subject to limited exceptions.

1 Disclaimer of unprofitable contracts

Under section 568 of the Corporations Act, any property of an Australian Company at any time, including any unprofitable contract entered into by the Australian Company, may be subject to disclaimer by the liquidator. However, a liquidator requires the leave of the Court to disclaim a contract (other than a lease of land or an unprofitable contract). Where it is effective, the disclaimer is taken to have terminated the Australian Company's rights, interests, liabilities and property in respect of the disclaimed property, but does not affect any other person's rights or liabilities except so far as necessary in order to release the company and its property from liability.

[180] Section 468 applies only to dispositions by the Australian Company itself. It does not apply to action taken by the FCM to exercise rights in relation to property the subject of the Clearing Agreement.

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2 Voidable transactions

Under section 588FE of the Corporations Act, the following types of transactions[181] may, by order of the court, be set aside or modified on application of a liquidator of an Australian Company within the following suspect periods (such transactions are described as voidable transactions):

Type	Suspect period*
Insolvent transaction which is an unfair preference	6 months
Insolvent transaction which is an uncommercial transaction	2 years
Insolvent transaction ~~(which is also an unfair preference or an uncommercial transaction) and~~ which is for the purpose of defeating, delaying or interfering with creditor's rights on a winding-up	10 years

[181] We assume that there are no separate transactions as between the Customer and the FCM which:

(a) constitute a loan;

(b) involve a payment, disposition or issue of securities to, or to be made to, a director or close associate of a director of the Customer or a person on behalf of, or for the benefit of, either of such persons; or

(c) involve a "related entity" (as defined in the Corporations Act) of the Customer.

On this basis, in our view, there should be no transactions between the Customer and the FCM which could constitute an unfair loan, an unreasonable director-related transaction or an insolvent transaction where a "related entity" of the Customer is a party to the transaction, within the meaning of sections 588FD, 588FDA, 588FC and 588FH (respectively) of the Corporations Act, and we do not consider those sections further in this opinion.

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Type	Suspect period*
Insolvent transaction where a "related entity"[141] of the Covered Customer is a party to the transaction Creditor-defeating disposition[182]	4 years12 months

[141] The definition of a "related entity" of the Covered Customer means (see section 9 of the *Corporations Act*):

(a) a promoter of the Covered Customer, a relative, spouse or de facto spouse of any such promoter, and a relative of a spouse or of a de facto spouse of any such promoter;

(b) a director or member of the Covered Customer or a related body corporate of the Covered Customer, a relative, spouse or de facto spouse of any such director or member, and a relative of a spouse or of a de facto spouse of any such director or member;

(c) a body corporate that is related to the Covered Customer;

(d) a beneficiary under a trust of which the Covered Customer is or has at any time been the trustee, a relative, spouse or de facto spouse of any such beneficiary, and a relative of a spouse or of a de facto spouse of any such beneficiary;

(e) a body corporate one of whose directors is also a director of the Covered Customer; and

(f) a trustee of a trust of which a person is a beneficiary, where the person is a related entity of the Covered Customer because of the application of one or more of paragraphs (a) to (e).

[182] Relevantly, a creditor-defeating disposition of property of a company is voidable if at least one of the following applies:

(a) the transaction was entered into, or an act was done for the purposes of giving effect to it, when the company was insolvent, during the 12 months ending on the relation-back day;

(b) the company became insolvent because of the transaction or an act done for the purposes of giving effect to the transaction during the 12 months ending on the relation-back day;

(c) less than 12 months after the transaction or an act done for the purposes of giving effect to the transaction, the start of an external administration (as defined in the Corporations Act) of the company occurs as a direct or indirect result of the transaction or act.

However, a creditor-defeating disposition is not voidable if the transaction, or the act done to give effect to it, was entered into, or done, under a compromise or arrangement approved by a court under section 411 of the Corporations Act, under a deed of company arrangement executed by the company or by an administrator, liquidator, or provisional liquidator of the company, and a transaction may be voidable as a creditor-defeating disposition only if entered into on or after 18 February 2020.

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Type	Suspect period*
~~Unreasonable director-related transaction~~4 years~~*~~ Generally this refers to when the transaction was entered into, or an act was done for the purposes of giving effect to transaction, within this period before the date ("**relation-back day**") which is the date determined in accordance with section 91 of the Corporations Act.[183]	
~~Unfair loan~~	~~whenever made~~

2.1 Insolvent transactions

~~* Transaction entered into, or act done for the purposes of giving effect to transaction, within this period before the date, "**relation-back day**", which is the date determined in accordance with section 91 of the *Corporations Act*.~~

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

~~A transaction~~ A transaction to which an Australian Company is a party[184] will be an "insolvent transaction" if it is an unfair preference given by an Australian Company or an uncommercial transaction of an Australian Company where at the time of entering into the transaction the Australian Company is insolvent or where the Australian Company becomes insolvent because of the

[183] The *Insolvency Law Reform Act 2016* (Cth) inserted section 91 into the Corporations Act, commencing 1 March 2017. Section 91 specifies the particular relation-back day which will apply depending on the specific circumstances. For further detail on the suspect periods, see also the above footnote in respect of creditor-defeating dispositions, and section 588FE more generally.

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

transaction.[185] The word "insolvent" means an inability to pay debts as and when they become due and payable. Unfair preferences and uncommercial transactions are discussed in turn below.

(a) **Unfair preferences**

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

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

(b) **Uncommercial transactions**

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

[185] However, we note sections 588FE(2A) and 588FE(2B) apply where a company was under administration or subject to a deed of company arrangement immediately before the company resolved that it be wound up or the court ordered that it be wound up. Consideration of these sections is beyond the scope of this opinion.

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~~An unreasonable director-related transaction includes, among other things, a payment made by an Australian Company, and a conveyance, transfer or other disposition of property in an Australian Company, where the payment, conveyance, transfer or disposition is made to a director of the company, close associate of a director of the company or a person on behalf of, or for the benefit of, a director of the company. We assume this would not be applicable to a transfer of Eligible Collateral by the Covered Customer to the Clearing Member.~~

(c) **Creditor-defeating dispositions**

Under section 588FE(6B) of the Corporations Act, a transaction is a creditor-defeating disposition where property of an Australian Company is disposed[186] for less than market value (or, if lower, the best reasonably obtainable price, having regard to the circumstances at the time), where that disposition has the effect of preventing the property from becoming, or hindering or significantly delaying the process of making the property, available for the benefit of the company's creditors in its winding-up.

(d) **Exceptions to voidability**

However, if an Australian Company goes into liquidation, a transaction entered into during the suspect period which may be voidable (i.~~e.~~ any of the "Types" of transaction referred to above ~~other than an unfair loan or unreasonable director-related transaction~~) would not be voidable against a creditor if certain conditions are satisfied. Under section 588FG(2) of the Corporations Act, an Australian Court cannot make an order in respect of an unfair preference ~~or~~ , an uncommercial transaction or a creditor-defeating disposition[187] which materially prejudices a right or interest of a person if it is proved that:

[186] A transaction that results in another person becoming the owner of property that did not previously exist is considered to be a disposition of property. Additionally, where a company makes a disposition of property to another person and that other person gives some or all of the consideration for the disposition to a third party other than the company, that company is taken to have made a disposition of that property constituting so much of the consideration as was given to the third party.

[187] In respect of creditor-defeating dispositions, the provisions described in paragraph 3.1(d) do not apply to an order made solely on the grounds that, less than 12 months after the transaction or an act done for the purposes of giving effect to the transaction, the

(i) ~~(a)~~the person became a party to the transaction in good faith. Good faith would be absent if there were fraud or if there subsisted an intention on the part of the creditor to obtain an advantage vis-à-vis the other creditors of the Australian Company. A transaction entered into as part of the ordinary course of business would not of itself result in the inference that there was an absence of good faith; and

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

() ~~(i)~~the person had no reasonable grounds for suspecting that the Australian Company was insolvent (in the sense that the Australian Company was unable to pay all its debts as and when they become due and payable) or would become insolvent if it entered into the transaction; and

(A) ~~(ii)~~a reasonable person in their circumstances would have had no grounds for so suspecting~~.~~;[188] and

~~The notion "reasonable grounds for suspecting" embodies something which, in all the circumstances, would create in the mind of a reasonable person in the position of the creditor an actual apprehension or fear that the Australian Company was unable to pay its debts when they became due and payable. The notion also embodies a mistrust of the Australian Company's ability to pay its debts as they become due, and an appreciation of the advantage which the creditor's acceptance of the payment would have as between the creditor and other creditors of the Australian Company; and~~

start of an external administration (as defined in the Corporations Act) of the company occurs as a direct or indirect result of the transaction or act. Further, other exceptions to voidability may apply in respect of a creditor-defeating disposition.

[188] The notion "reasonable grounds for suspecting" embodies something which, in all the circumstances, would create in the mind of a reasonable person in the position of the creditor an actual apprehension or fear that the Australian Company was unable to pay its debts when they became due and payable. The notion also embodies a mistrust of the Australian Company's ability to pay its debts as they become due, and an appreciation of the advantage which the creditor's acceptance of the payment would have as between the creditor and other creditors of the Australian Company.

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(iii) (c)the person provided valuable consideration under the transaction or changed its position in reliance on the transaction. In this context, the valuable consideration must be real and not colourable in the sense of being contrived or without substance.

The Australian Courts will take a substantive approach on these issues. If the transaction effects the satisfaction of obligations subsisting under an earlier transaction, at a time when the obligor is insolvent, then the second transaction could be preferential unless the defences set out above are established.

Having regard to the above matters, it is difficult to see how the provision of Eligible Collateral at or about the same time that a Futures Transaction or Cleared Derivatives Transaction is entered into under the Covered Base Agreement or CDA would be regarded as an unfair preference where it is not referable to any existing indebtedness. We also think that the provision of Eligible Collateral which effects:

(i) improvements in the value of Eligible Collateral pursuant to substitution (that is, where the substituted Eligible Collateral was more valuable than the Eligible Collateral it replaced); or

(ii) the provision of additional Eligible Collateral for existing Transactions to maintain the required value of Eligible Collateral in respect of Covered Transactions that were in existence before the provision of the additional Eligible Collateral (that is, in commercial parlance, "top up Collateral"),

in most cases would be considered to be for valuable consideration.[142] Therefore, provided the substitution or additional Eligible Collateral is received in good faith without knowledge or suspicion of insolvency, it should not be regarded as an unfair preference.

[142] There is no authority that we have been able to find which is directly on point. Keay, *McPherson - The Law of Company Liquidation* (4th Edn, LBC Information Services) p 482 states:

"In most claims by a liquidator in which it is alleged that the transaction was an unfair preference the defendant will have little difficulty in establishing valuable consideration (Historically, "valuable consideration" has not been an issue in cases involving defences to preferences under s122(2) of the *Bankruptcy Act*: Purcell, "Banks and the Recovery of Voidable Preferences" (1990) 2 Bond LR 107 at 112).

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It is unlikely that Eligible Collateral provided in connection with a Futures Transaction or Cleared

This is because, in the normal course of things, the debtor company will have paid the defendant the price, or part thereof, for services rendered or goods supplied and prior indebtedness is good consideration for a payment made in discharge of that indebtedness (*Taylor v White* (1964) 110 CLR 129 at 139; *Kyra Nominees Pty Ltd (in liq) v National Australia Bank Ltd* (1964) 4 ACLC 400 at 407).

Where the company entered into a transaction that involved something other than a payment, the issue of valuable consideration may be a live one. As an example, if the company grants to the creditor security for an existing debt, the creditor must demonstrate that some valuable consideration was given for the security (Rose, *Lewis' Australian Bankruptcy Law* (10th ed, Law Book Co, Sydney, 1994), p 183)."

There is very little authority as to what consideration the holder of a security interest which secures an antecedent debt must provide in order for the holder to have provided valuable consideration for it within section 588FG(2)(c). (One example is a forbearance to sue for the antecedent debt (*Re Hyams* (1970) 19 FLR 232: *PT Garuda Indonesia Ltd v Grellman* (1992) 107 ALR 199, which concern a similar defence in relation to voidable settlements under the Bankruptcy Act). In *N. A. Kratzmann Pty Ltd v Tucker* (1966) 123 CLR 257 the issue was whether a mortgage given by a company as security for money owing to a mortgagee company was void as a preference. The mortgage was executed within the six months before the winding up of the company but the mortgagee argued that the mortgage was executed in pursuance of an agreement to do so entered into before the commencement of the six month period. The court found that such an agreement was not supported on the facts. However, the reasoning proceeded on the assumption that if such an agreement had existed, the transaction would not have been viewed as a preference on the basis of absence of valuable consideration.

The difference between the facts in that case and the Covered Base Agreement and CDA is that the Covered Base Agreement and CDA are entered into at the beginning of the trading relationship (or at some point in time in respect of future transactions - these comments only apply to exposures which arise under transactions entered into on or after the time the Covered Base Agreement and CDA is entered into). The agreement to provide additional Eligible Collateral once a Delivery Amount arises is not a new agreement made at the time the additional Eligible Collateral is provided, which would require fresh consideration eg a forbearance to sue, at that time. Rather the provision of additional Eligible Collateral constitutes the performance of an obligation agreed to, and supported by consideration at the time the Covered Base Agreement and CDA is entered into. Accordingly, we have concluded that the provision of additional Eligible Collateral constitutes a discharge by the Covered Customer of their pre-existing obligation to provide the additional Eligible Collateral. It is therefore analogous to a debtor discharging a debt for services rendered previously to the debtor by the creditor.

In the case of substitutions, the analysis is that:

(a) if the substitution is permitted without consent, there is a pre-existing agreement to provide substitute collateral if the Covered Customer calls for the return of Eligible Collateral. So under the same analysis as for top up collateral, the Covered Customer is performing a pre-existing obligation in providing the substitute collateral; and

(b) if the substitution requires consent, consideration is given at the time of the substitution (ie the Clearing Member's agreement to release the security over the substituted Eligible Collateral).

The consideration provided need not be equal to the value of the substitute Eligible Collateral.

The above analysis assumes that the parties are dealing at arms' length on ordinary commercial terms for transactions of this nature. If they are not, an analysis should take place as to whether the consideration is real and not colourable in the sense of being contrived or without substance.

Derivatives Transaction entered into at a commercial rate as part of an arm's length dealing would be characterised as an uncommercial transaction. We assume that the provision of any Eligible Collateral may only be used to discharge obligations under the Covered Base Agreement or CDA and any excess must be returned.

Void dispositions

Section 468 of the *Corporations Act* renders void any disposition of property of an Australian Company[143] effected after the commencement of the winding up by an Australian Court. Section 468 does not apply to exempt dispositions, which include dispositions by a liquidator, an administrator or a payment on or prior to the date of the winding up order by an Australian Company in good faith and in the ordinary course of banking business.

Section 437D also renders void any transaction or other dealing affecting the property of an Australian Company under administration, unless the administrator entered into it on the Australian Company's behalf, the administrator consented to it in writing before it was entered into, or it was entered into under an order of an Australian Court, subject to limited exceptions.

3 Voluntary alienation to defraud creditors

Under section 37A of *the Conveyancing Act 1919* (NSW) (and its equivalent in other Australian Jurisdictions such as section 172 of the *Property Law Act 1958* (Vic)), alienation of property made with intent to defraud creditors is rendered voidable by any person prejudiced by the alienation. In New South Wales, this law does not apply to any interest in property alienated to a purchaser in good faith not having, at the time of the alienation, notice of the intent to defraud creditors. Equally, in Victoria, the relevant law does not extend to any interest in property alienated for valuable consideration and in good faith or upon good consideration and in good faith to any person not having, at the time of the alienation, notice of the intent to defraud creditors.

[143] Section 468 applies only to dispositions by the Australian Company itself. It does not apply to action taken by a Secured Party to exercise rights in relation to property the subject of a Covered Base Agreement and CDA.

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SCHEDULE 8

Other circumstances that might affect enforcement where the *Netting Act* does not apply

In circumstances where the *Netting Act* does not apply, legislation including the following may affect the enforcement of a security interest:

1 **ADIs (which would include building societies and credit unions) for the purposes of the *Banking Act*.**

If the Covered Customer is one of these entities, the *Banking Act* and the *Reserve Bank Act 1959* (Cth) ("***Reserve Bank Act***") are potentially relevant to the enforceability of security provided by them.

No provision of the *Banking Act* or the *Reserve Bank Act* prohibits an ADI from granting security over its assets.

In respect of ADIs, the claims mandatorily preferred by law include the claims referred to in sections 13A(3) and 16 of the *Banking Act* and section 86 of the *Reserve Bank Act*, as summarised below.

(a) Section 13A(3) of the *Banking Act* provides that in the event an ADI becomes unable to meet its obligations or suspends payment, the assets of the ADI in Australia are to be available to satisfy:

(i) first, certain obligations of the ADI to APRA (if any) arising under Division 2AA of Part II of the *Banking Act* in respect of amounts payable by APRA to holders of "protected accounts" (as defined in the *Banking Act*) in connection with the Financial Claims Scheme ("**FCS**") established under the *Banking Act*;

(ii) second, APRA's costs (if any) in exercising its powers and performing its functions relating to the ADI in connection with the FCS;

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(iii) third, the ADI's liabilities (if any) in Australia in relation to protected accounts that account-holders keep with the ADI;

(iv) fourth, the ADI's debts (if any) to the Reserve Bank of Australia ("**RBA**"); and

(v) fifth, the ADI's liabilities (if any) under an industry support contract that is certified under section 11CB of the *Banking Act*,

in each case, in priority to all other liabilities of the ADI. The assets of the ADI are taken for the purposes of section 13A(3) not to include any interest in an asset (or a part of an asset) in a cover pool for covered bonds for which the ADI is the issuer.

(b) Section 16 of the *Banking Act* provides that certain other debts of an ADI due to APRA shall, in the winding up of the ADI, have, subject to section 13A(3) of the *Banking Act*, priority over all other unsecured debts of the ADI.

(c) Section 86 of the *Reserve Bank Act* provides that, subject to section 13A(3) of the *Banking Act*, debts of a bank due to the RBA shall, in a winding up of the bank, have priority over all other debts of the ADI.

In addition, under the *Banking Act*, any other party to a contract to which the ADI is a party may not deny any obligations under that contract, accelerate any debt under that contract, close out any transaction relating to that contract, or enforce any security under that contract on the grounds that:

(i) the ADI is subject to a direction by APRA under the *Banking Act* (see sections 11CD and 13N of the *Banking Act*); or

(ii) an ADI statutory manager (as defined in the *Banking Act*):

(i) is in control of the ADI's business (see section 15C of the *Banking Act*); or

(ii) takes various actions in respect of any shares in the ADI (see section 14AC of the *Banking Act*).

Division 2 of Part 4 of the *Netting Act* sets out the circumstances in which non-direction stays (including sections 14AC and 15C of the *Banking Act*) may cease in relation to:

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(A) a close-out netting contract to which a regulated body (as defined in the *Netting Act*) is a party (and which satisfies the requirements in section 15A(1) of the *Netting Act*); or

(B) a security given over financial property, in respect of an obligation of a party to a close-out netting contract to which a regulated body is a party (and which satisfies the requirements in section 15A(2) of the *Netting Act*).

The circumstances in which non-direction stays may cease is considered further in Schedule 4 to this memorandum.

2 Insurance companies

Section 187 of the *Life Insurance Act* provides that in a winding up, the assets of the statutory funds are to be applied:

(a) first, in discharging preferred creditors as identified in section 556(1) of the *Corporations Act*;[145] and

(b) second, in discharging of liabilities to policy holders; and

(c) third, in discharging of other liabilities that are referrable to the business of the statutory fund; and

(d) if there are any assets remaining, as the Court directs.

Under section 116(3) of the *Insurance Act*, in the winding up of a general insurance company, its assets in Australia may not be applied to discharge its liabilities other than its liabilities in Australia unless it has no liabilities in Australia.

In addition, under the *Life Insurance Act* and *Insurance Act*, a counterparty to a contract to which the life company or general insurer (as applicable) is a party may not deny any obligations under that

[145] Only the extent that debts or claims are liabilities that are referable to the business of the primary fund: section 187(2) of the *Life Insurance Act*.

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contract, accelerate any debt under that contract, close out any transaction relating to that contract, or enforce any security under that contract on the grounds that:

(i) the life company or general insurer (as applicable) is subject to a direction by APRA under the *Life Insurance Act* or *Insurance Act* (as applicable) (see sections 103K and 105 of the *Insurance Act* and sections 230AJ and 230C of the *Life Insurance Act*); or

(ii) in respect of a judicial manager (as defined in the *Life Insurance Act* or *Insurance Act* (as applicable)):

(i) the management of the life company, or of part of the business of the life company is vested in the judicial manager (see section 165B of the *Life Insurance Act*) or the management of the general insurer is vested in the judicial manager (see section 62V of the *Insurance Act*); or

(ii) the judicial manager takes various actions in respect of any shares in the life company or general insurer (see section 168C of the *Life Insurance Act* and section 62ZB of the *Insurance Act*).

Division 2 of Part 4 of the *Netting Act* sets out the circumstances in which non-direction stays (including, relevantly, sections 165B and 168C of the *Life Insurance Act* and sections 62V and 62ZB of the *Insurance Act*) may cease in relation to:

(A) a close-out netting contract to which a regulated body (as defined in the *Netting Act*) is a party (and which satisfies the requirements in section 15A(1) of the *Netting Act*); or

(B) a security given over financial property, in respect of an obligation of a party to a close-out netting contract to which a regulated body is a party (and which satisfies the requirements in section 15A(2) of the *Netting Act*).

The circumstances in which non-direction stays may cease is considered further in Schedule 4 to this memorandum.

3 Business Transfer Act

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Under the *Business Transfer Act*, if a body corporate that is, or is proposed to become, a transferring body (as defined in the *Business Transfer Act*) is or was party to a contract, the fact that an act is done for the purposes of Division 2 or 3 of the *Business Transfer Act*, or that a certificate of transfer comes into force under Division 3 of the *Business Transfer Act*, in connection with the body does not allow the contract, or any other party to the contract, to deny any obligations under that contract, accelerate any debt under that contract, close out any transaction relating to that contract or enforce any security under that contract.[146]

Division 2 of Part 4 of the *Netting Act* sets out the circumstances in which non-direction stays (including, relevantly, section 36AA of the *Business Transfer Act*) may cease in relation to:

(a) a close-out netting contract to which a regulated body (as defined in the *Netting Act*) is a party (and which satisfies the requirements in section 15A(1) of the *Netting Act*); or

(b) a security given over financial property, in respect of an obligation of a party to a close-out netting contract to which a regulated body is a party (and which satisfies the requirements in section 15A(2) of the *Netting Act*).

Disclaimer of unprofitable contracts

Under section 568 of the *Corporations Act*, any property of an Australian Company at any time, including any unprofitable contract entered into by the Australian Company, may be subject to disclaimer by the liquidator. However, a liquidator requires leave of an Australian Court to disclaim a contract other than an unprofitable contract). Where it is effective, the disclaimer is taken to have terminated the Australian Company's rights, interests, liabilities and property in respect of the disclaimed property, but does not affect any other person's rights or liabilities except so far as necessary in order to release the company and its property from liability.

Circulating assets

Under section 588FJ of the *Corporations Act*, if the Australian Company is being wound up then a circulating security interest which is created within 6 months before the relation-back day (or after that

[146] *Business Transfer Act*, section 36AA.

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date) is void as against the Australian Company's liquidator except so far as it secures, essentially, the giving of some new benefit to the Australian Company (such as an advance at or after the time the security interest was created) or if it is proved that the Australian Company was solvent immediately after that time.

Late registration

Section 588FL of the *Corporations Act* describes the impact of late registration of a security interest if a company is subject to winding up, administration or a deed of company arrangement. Under Section 588FL of the *Corporations Act* a security interest which is perfected only by registration vests in the grantor (defeating the secured party) if the registration takes place after the latest of the date which is (a) 6 months before the critical time (the critical time relates to the time at which winding up or administration is taken to commence);[144] (b) the end of 20 business days after the security agreement comes into force or if earlier, the critical time; or (c) in the case of a security interest which came into force under a foreign law but first became enforceable against third parties under the law of Australia after 6 months before the critical time, 56 days after it became enforceable under Australian Law (or if earlier, the critical time).

The circumstances in which non-direction stays may cease is considered further in Schedule 4 to this memorandum.

[144] Critical time is defined in footnote 139.

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APPENDIX A

(AUGUST 2015)

CERTAIN DERIVATIVES TRANSACTIONS

Basis Swap. A transaction in which one party pays periodic amounts of a given currency based on a floating rate and the other party pays periodic amounts of the same currency based on another floating rate, with both rates reset periodically; all calculations are based on a notional amount of the given currency.

Bond Forward. A transaction in which one party agrees to pay an agreed price for a specified amount of a bond of an issuer or a basket of bonds of several issuers at a future date and the other party agrees to pay a price for the same amount of the same bond to be set on a specified date in the future. The payment calculation is based on the amount of the bond and can be physically-settled (where delivery occurs in exchange for payment) or cash-settled (where settlement occurs based on the difference between the agreed forward price and the prevailing market price at the time of settlement).

Bond Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified amount of a bond of an issuer, such as Kingdom of Sweden or Unilever N.V., at a specified strike price. The bond option can be settled by physical delivery of the bonds in exchange for the strike price or may be cash settled based on the difference between the market price of the bonds on the exercise date and the strike price.

Bullion Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified number of Ounces of Bullion at a specified strike price. The option may be settled by physical delivery of Bullion in exchange for the strike price or may be cash settled based on the difference between the market price of Bullion on the exercise date and the strike price.

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Bullion Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency or a different currency calculated by reference to a Bullion reference price (for example, Gold-COMEX on the COMEX Division of the New York Mercantile Exchange) or another method specified by the parties. Bullion swaps include cap, collar or floor transactions in respect of Bullion.

Bullion Trade. A transaction in which one party agrees to buy from or sell to the other party a specified number of Ounces of Bullion at a specified price for settlement either on a "spot" or two-day basis or on a specified future date. A Bullion Trade may be settled by physical delivery of Bullion in exchange for a specified price or may be cash settled based on the difference between the market price of Bullion on the settlement date and the specified price.

For purposes of Bullion Trades, Bullion Options and Bullion Swaps, "Bullion" means gold, silver, platinum or palladium and "Ounce" means, in the case of gold, a fine troy ounce, and in the case of silver, platinum and palladium, a troy ounce (or in the case of reference prices not expressed in Ounces, the relevant Units of gold, silver, platinum or palladium).

Buy/Sell-Back Transaction. A transaction in which one party purchases a security (in consideration for a cash payment) and agrees to sell back that security (or in some cases an equivalent security) to the other party (in consideration for the original cash payment plus a premium).

Cap Transaction. A transaction in which one party pays a single or periodic fixed amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified floating rate (in the case of an interest rate cap), rate or index (in the case of an economic statistic cap) or commodity price (in the case of a commodity cap) in each case that is reset periodically over a specified per annum rate (in the case of an interest rate cap), rate or index (in the case of an economic statistic cap) or commodity price (in the case of a commodity cap).

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

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Commodity Forward. A transaction in which one party agrees to purchase a specified quantity of a commodity at a future date at an agreed price, and the other party agrees to pay a price for the same quantity to be set on a specified date in the future. A Commodity Forward may be settled by the physical delivery of the commodity in exchange for the specified price or may be cash settled based on the difference between the agreed forward price and the prevailing market price at the time of settlement.

Commodity Index Transaction. A transaction, structured in the form of a swap, cap, collar, floor, option or some combination thereof, between two parties in which the underlying value of the transaction is based on a rate or index based on the price of one or more commodities.

Commodity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified quantity of a commodity at a specified strike price. The option can be settled either by physically delivering the quantity of the commodity in exchange for the strike price or by cash settling the option, in which case the seller of the option would pay to the buyer the difference between the market price of that quantity of the commodity on the exercise date and the strike price.

Commodity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price and the other party pays periodic amounts of the same currency based on the price of a commodity, such as natural gas or gold, or a futures contract on a commodity (e.g., West Texas Intermediate Light Sweet Crude Oil on the New York Mercantile Exchange); all calculations are based on a notional quantity of the commodity.

Contingent Credit Default Swap. A Credit Default Swap Transaction under which the calculation amounts applicable to one or both parties may vary over time by reference to the mark-to-market value of a hypothetical swap transaction.

Credit Default Swap Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to enter into a Credit Default Swap.

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Credit Default Swap. A transaction in which one party pays either a single fixed amount or periodic fixed amounts or floating amounts determined by reference to a specified notional amount, and the other party (the credit protection seller) pays either a fixed amount or an amount determined by reference to the value of one or more loans, debt securities or other financial instruments (each a "Reference Obligation") issued, guaranteed or otherwise entered into by a third party (the "Reference Entity") upon the occurrence of one or more specified credit events with respect to the Reference Entity (for example, bankruptcy or payment default). The amount payable by the credit protection seller is typically determined based upon the market value of one or more debt securities or other debt instruments issued, guaranteed or otherwise entered into by the Reference Entity. A Credit Default Swap may also be physically settled by payment of a specified fixed amount by one party against delivery of specified obligations ("Deliverable Obligations") by the other party. A Credit Default Swap may also refer to a "basket" (typically ten or less) or a "portfolio" (eleven or more) of Reference Entities or may be an index transaction consisting of a series of component Credit Default Swaps.

Credit Derivative Transaction on Asset-Backed Securities. A Credit Default Swap for which the Reference Obligation is a cash or synthetic asset-backed security. Such a transaction may, but need not necessarily, include "pay as you go" settlements, meaning that the credit protection seller makes payments relating to interest shortfalls, principal shortfalls and write-downs arising on the Reference Obligation and the credit protection buyer makes additional fixed payments of reimbursements of such shortfalls or write-downs.

Credit Spread Transaction. A transaction involving either a forward or an option where the value of the transaction is calculated based on the credit spread implicit in the price of the underlying instrument.

Cross Currency Rate Swap. A transaction in which one party pays periodic amounts in one currency based on a specified fixed rate (or a floating rate that is reset periodically) and the other party pays periodic amounts in another currency based on a floating rate that is reset periodically. All calculations are determined on predetermined notional amounts of the two currencies; often such swaps will involve initial and or final exchanges of amounts corresponding to the notional amounts.

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Currency Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified amount of a given currency at a specified strike price.

Currency Swap. A transaction in which one party pays fixed periodic amounts of one currency and the other party pays fixed periodic amounts of another currency. Payments are calculated on a notional amount. Such swaps may involve initial and or final payments that correspond to the notional amount.

Economic Statistic Transaction. A transaction in which one party pays an amount or periodic amounts of a given currency by reference to interest rates or other factors and the other party pays or may pay an amount or periodic amounts of a currency based on a specified rate or index pertaining to statistical data on economic conditions, which may include economic growth, retail sales, inflation, consumer prices, consumer sentiment, unemployment and housing.

Emissions Allowance Transaction. A transaction in which one party agrees to buy from or sell to the other party a specified quantity of emissions allowances or reductions at a specified price for settlement either on a "spot" basis or on a specified future date. An Emissions Allowance Transaction may also constitute a swap of emissions allowances or reductions or an option whereby one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which the specified quantity of emissions allowances or reductions exceeds or is less than a specified strike. An Emissions Allowance Transaction may be physically settled by delivery of emissions allowances or reductions in exchange for a specified price, differing vintage years or differing emissions products or may be cash settled based on the difference between the market price of emissions allowances or reductions on the settlement date and the specified price.

Equity Forward. A transaction in which one party agrees to pay an agreed price for a specified quantity of shares of an issuer, a basket of shares of several issuers or an equity index at a future date and the other party agrees to pay a price for the same quantity and shares to be set on a specified date in the future. The payment calculation is based on the number of shares and can be physically-settled (where delivery occurs in exchange for payment) or cash-settled (where settlement occurs based on the difference between the agreed forward price and the prevailing market price at the time of settlement).

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Equity Index Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which an equity index either exceeds (in the case of a call) or is less than (in the case of a put) a specified strike price.

Equity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified number of shares of an issuer or a basket of shares of several issuers at a specified strike price. The share option may be settled by physical delivery of the shares in exchange for the strike price or may be cash settled based on the difference between the market price of the shares on the exercise date and the strike price.

Equity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed or floating rate and the other party pays periodic amounts of the same currency or a different currency based on the performance of a share of an issuer, a basket of shares of several issuers or an equity index, such as the Standard and Poor's 500 Index.

Floor Transaction. A transaction in which one party pays a single or periodic amount and the other party pays periodic amounts of the same currency based on the excess, if any, of a specified per annum rate (in the case of an interest rate floor), rate or index level (in the case of an economic statistic floor) or commodity price (in the case of a commodity floor) over a specified floating rate (in the case of an interest rate floor), rate or index level (in the case of an economic statistic floor) or commodity price (in the case of a commodity floor).

Foreign Exchange Transaction. A deliverable or non-deliverable transaction providing for the purchase of one currency with another currency providing for settlement either on a "spot" or two-day basis or a specified future date.

Forward Rate Transaction. A transaction in which one party agrees to pay a fixed rate for a defined period and the other party agrees to pay a rate to be set on a specified date in the future. The payment calculation is based on a notional amount and is settled based, among other things, on the difference between the agreed forward rate and the prevailing market rate at the time of settlement.

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Freight Transaction. A transaction in which one party pays an amount or periodic amounts of a given currency based on a fixed price and the other party pays an amount or periodic amounts of the same currency based on the price of chartering a ship to transport wet or dry freight from one port to another; all calculations are based either on a notional quantity of freight or, in the case of time charter transactions, on a notional number of days.

Fund Option Transaction: A transaction in which one party grants to the other party (for an agreed payment or other consideration) the right, but not the obligation, to receive a payment based on the redemption value of a specified amount of an interest issued to or held by an investor in a fund, pooled investment vehicle or any other interest identified as such in the relevant Confirmation (a "Fund Interest"), whether i) a single class of Fund Interest of a Single Reference Fund or ii) a basket of Fund Interests in relation to a specified strike price. The Fund Option Transactions will generally be cash settled (where settlement occurs based on the excess of such redemption value over such specified strike price (in the case of a call) or the excess of such specified strike price over such redemption value (in the case of a put) as measured on the valuation date or dates relating to the exercise date).

Fund Forward Transaction: A transaction in which one party agrees to pay an agreed price for the redemption value of a specified amount of i) a single class of Fund Interest of a Single Reference Fund or ii) a basket of Fund Interests at a future date and the other party agrees to pay a price for the redemption value of the same amount of the same Fund Interests to be set on a specified date in the future. The payment calculation is based on the amount of the redemption value relating to such Fund Interest and generally cash-settled (where settlement occurs based on the difference between the agreed forward price and the redemption value measured as of the applicable valuation date or dates).

Fund Swap Transaction: A transaction a transaction in which one party pays periodic amounts of a given currency based on a fixed price or a fixed rate and the other party pays periodic amounts of the same currency based on the redemption value of i) a single class of Fund Interest of a Single Reference Fund or ii) a basket of Fund Interests.

Interest Rate Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to receive a payment equal to the amount by which an

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interest rate either exceeds (in the case of a call option) or is less than (in the case of a put option) a specified strike rate.

Interest Rate Swap. A transaction in which one party pays periodic amounts of a given currency based on a specified fixed rate and the other party pays periodic amounts of the same currency based on a specified floating rate that is reset periodically, such as the London inter-bank offered rate; all calculations are based on a notional amount of the given currency.

Longevity/Mortality Transaction. (a) A transaction employing a derivative instrument, such as a forward, a swap or an option, that is valued according to expected variation in a reference index of observed demographic trends, as exhibited by a specified population, relating to aging, morbidity, and mortality/longevity, or (b) A transaction that references the payment profile underlying a specific portfolio of longevity- or mortality- contingent obligations, e.g. a pool of pension liabilities or life insurance policies (either the actual claims payments or a synthetic basket referencing the profile of claims payments).

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

Property Index Derivative Transaction. A transaction, often structured in the form of a forward, option or total return swap, between two parties in which the underlying value of the transaction is based on a rate or index based on residential or commercial property prices for a specified local, regional or national area.

Repurchase Transaction. A transaction in which one party agrees to sell securities to the other party and such party has the right to repurchase those securities (or in some cases equivalent securities) from such other party at a future date.

Securities Lending Transaction. A transaction in which one party transfers securities to a party acting as the borrower in exchange for a payment or a series of payments from the borrower and the borrower's obligation to replace the securities at a defined date with identical securities.

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Swap Deliverable Contingent Credit Default Swap. A Contingent Credit Default Swap under which one of the Deliverable Obligations is a claim against the Reference Entity under an ISDA Master Agreement with respect to which an Early Termination Date (as defined therein) has occurred.

Swap Option. A transaction in which one party grants to the other party the right (in consideration for a premium payment), but not the obligation, to enter into a swap with certain specified terms. In some cases the swap option may be settled with a cash payment equal to the market value of the underlying swap at the time of the exercise.

Total Return Swap. A transaction in which one party pays either a single amount or periodic amounts based on the total return on one or more loans, debt securities or other financial instruments (each a "Reference Obligation") issued, guaranteed or otherwise entered into by a third party (the "Reference Entity"), calculated by reference to interest, dividend and fee payments and any appreciation in the market value of each Reference Obligation, and the other party pays either a single amount or periodic amounts determined by reference to a specified notional amount and any depreciation in the market value of each Reference Obligation.

A total return swap may (but need not) provide for acceleration of its termination date upon the occurrence of one or more specified events with respect to a Reference Entity or a Reference Obligation with a termination payment made by one party to the other calculated by reference to the value of the Reference Obligation.

Weather Index Transaction. A transaction, structured in the form of a swap, cap, collar, floor, option or some combination thereof, between two parties in which the underlying value of the transaction is based on a rate or index pertaining to weather conditions, which may include measurements of heating, cooling, precipitation and wind.

APPENDIX B

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(SEPTEMBER 2009)

ANNEX 4ANNEX 1

SUMMARY ANNEX

KING&WOOD MALLESONS

~~ANNEX 5~~ANNEX 2

INSTRUCTIONS

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Appendix A
SEPTEMBER 2009

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CERTAIN COUNTERPARTY TYPES[189]

Description	Covered by ~~Memorandum~~opinion	Legal form(s)
Bank/Credit Institution. A legal entity, which may be organized as a corporation, partnership or in some other form, that conducts commercial banking activities, that is, whose core business typically involves (a) taking deposits from private individuals and/or corporate entities and (b) making loans to private individual and/or corporate borrowers. This type of entity is sometimes referred to as a "commercial bank" or, if its business also includes investment banking and trading activities, a "universal bank". (If the entity only conducts investment banking and trading activities, then it falls within the "Investment Firm/Broker Dealer" category below.) This type of entity is referred to as a "credit institution" in European Community (**EC**) legislation. This category may include specialised types of bank, such as a mortgage savings bank (provided that the relevant entity accepts deposits and makes loans), or such an entity may be considered in the local jurisdiction to constitute a separate category of legal entity (as in the case of a building society in the United Kingdom (**UK**)).	Yes, covered by ~~Memorandum provided~~ our opinion if it is an Australian Company which is an Australian Bank (including that it is not an Excluded Company). Partnerships are not covered by ~~Memorandum~~our opinion.	Australian Company includes all Australian companies and corporations which have been registered as a company under the Corporations Act and companies which may be wound up under the Corporations Act and which have their centre of main interests (for the purposes of the Model Law) in Australia, but which are not Excluded Companies. ~~This includes all ADIs.~~ The easiest method of obtaining a degree of certainty as to whether an Australian entity is an Australian Company is to conduct a search of the company and business name register maintained by the Australian Securities and Investments Commission (which is accessible for free at ASIC's website: www.asic.gov.au). Further consideration then needs to be given to whether the entity is an Excluded Company.
Central Bank. A legal entity that performs the function of a central bank for a Sovereign or for an area of monetary union (as in the case of the European Central Bank in respect of the euro zone).	No, not covered by ~~Memorandum~~our opinion.[190]	

[189] In these definitions, the term "legal entity" means an entity with legal personality other than a private individual.

[190] Consideration of the position with regard to this counterparty type requires further legal analysis and is thus outside the scope of the current opinion.

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Description	Covered by ~~Memorandum~~opinion	Legal form(s)
Corporation. A legal entity that is organized as a corporation or company rather than a partnership, is engaged in industrial and/or commercial activities and does not fall within one of the other categories in this Appendix ~~B~~A.	Yes, covered by ~~Memorandum~~ our opinion provided it is an Australian Company (including that it is not an Excluded Company).	Australian Company includes all Australian companies and corporations which have been registered as a company under the Corporations Act and companies which may be wound up under the Corporations Act and which have their centre of main interests (for the purposes of the Model Law) in Australia, but which are not Excluded Companies. However, to be certain as to whether such an entity is an Australian Company, a company search would need to be conducted as described under "Bank/Credit Institution" above. Further consideration then needs to be given to whether the entity is an Excluded Company.
Hedge Fund/Proprietary Trader. A legal entity, which may be organized as a corporation, partnership or in some other legal form, the principal business of which is to deal in and/or manage securities and/or other financial instruments and/or otherwise to carry on an investment business predominantly or exclusively as principal for its own account.	Yes, covered by ~~Memorandum~~ our opinion provided it is an Australian Company (including that it is not an Excluded Company). Partnerships and individuals are not covered by ~~Memorandum~~our opinion.	Australian Company includes all Australian companies and corporations which have been registered as a company under the Corporations Act~~. However~~ and companies which may be wound up under the Corporations Act and which have their centre of main interests (for the purposes of the Model Law) in Australia, but which are not Excluded Companies. However, to be certain as to whether such an entity is an Australian Company, a company search would need to be conducted as described under "Bank/Credit Institution" above. Further consideration then needs to be given to whether the entity is an Excluded Company.

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Description	Covered by ~~Memorandum~~opinion	Legal form(s)
Insurance Company. A legal entity, which may be organised as a corporation, partnership or in some other legal form (for example, a friendly society or industrial & provident society in the UK), that is licensed to carry on insurance business, and is typically subject to a special regulatory regime and a special insolvency regime in order to protect the interests of policyholders.	~~Yes~~No, ~~covered by Memorandum provided it is an Australian Company. Partnerships and individuals are~~ not covered by ~~Memorandum~~our opinion.[191]	~~Australian Company includes all Australian companies which have been registered as a company under the *Corporations Act*.~~ ~~This includes most life insurance companies but to be certain as to whether such an entity is an Australian Company, a company search would need to be conducted as described under "Bank/Credit Institution" above.~~
International Organization. An organization of Sovereigns established by treaty entered into between the Sovereigns, including the International Bank for Reconstruction and Development (the World Bank), regional development banks and similar organizations established by treaty.	No, not covered by ~~Memorandum~~our opinion.[192]	

[191] Consideration of the position with regard to this counterparty type requires further legal analysis and is thus outside the scope of the current opinion.

[192] Consideration of the position with regard to this counterparty type requires further legal analysis and is thus outside the scope of the current opinion.

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Description	Covered by ~~Memorandum~~opinion	Legal form(s)
Investment Firm/Broker Dealer. A legal entity, which may be organized as a corporation, partnership or in some other form, that does not conduct commercial banking activities but deals in and/or manages securities and/or other financial instruments as an agent for third parties. It may also conduct such activities as principal (but if it does so exclusively as principal, then it most likely falls within the "Hedge Fund/Proprietary Trader" category above.) Its business normally includes holding securities and/or other financial instruments for third parties and operating related cash accounts. This type of entity is referred to as a "broker-dealer" in US legislation and as an "investment firm" in EC legislation.	Yes, covered by ~~Memorandum~~ our opinion provided it is an Australian Company, including a trustee of a unit trust (including where it is a managed investment scheme) (including that it is not an Excluded Company). Partnerships and individuals are not covered by ~~Memorandum~~our opinion.	Australian Company includes all Australian companies and corporations which have been registered as a company under the Corporations Act and companies which may be wound up under the Corporations Act and which have their centre of main interests (for the purposes of the Model Law) in Australia, but which are not Excluded Companies. ~~This includes all ADIs.~~ However~~,~~ to be certain as to whether such an entity is an Australian Company, a company search would need to be conducted as described under "Bank/Credit Institution" above. Further consideration then needs to be given to whether the entity is an Excluded Company.
Investment Fund. A legal entity or an arrangement without legal personality (for example, a common law trust) established to provide investors with a share in profits or income arising from property acquired, held, managed or disposed of by the manager(s) of the legal entity or arrangement or a right to payment determined by reference to such profits or income. This type of entity or arrangement is referred to as a "collective investment scheme" in EC legislation. It may be regulated or unregulated. It is typically administered by one or more persons (who may be private individuals and/or corporate entities) who have various rights and obligations governed by general law and/or, typically in the case of regulated Investment Funds, financial services legislation. Where the arrangement does not have separate legal personality, one or more representatives of the Investment Fund (for example, a trustee of a unit trust) contract on behalf of the Investment Fund, are owed the rights and owe the obligations provided for in the contract and are entitled to be indemnified out of the assets comprised in the arrangement.	Yes, covered by ~~Memorandum~~ our opinion to the extent that the relevant entity is a legal entity which is an Australian Company (including that it is not an Excluded Company).	Under Australian law, managed investment funds are not legal entities. The relevant legal entity is the trustee acting in its capacity as trustee of unit trusts (including managed investment schemes). ~~As per the statement at the commencement of our Memorandum, most~~ Most trustees of Australian unit trusts (including managed investment schemes) have been or are taken (by the Corporations Act) to have been registered as a company under the Corporations Act. However, to be certain as to whether such ~~a trustee~~ an entity is an Australian Company, a company search would need to be conducted as described under "Bank/Credit Institution" above. Further consideration then needs to be given to whether the entity is an Excluded Company.

Description	Covered by ~~Memorandum~~opinion	Legal form(s)
Local Authority. A legal entity established to administer the functions of local government in a particular region within a Sovereign or State of a Federal Sovereign, for example, a city, county, borough or similar area.	No, not covered by ~~Memorandum~~our opinion.[193]	
Partnership. A legal entity or form of arrangement without legal personality that is (a) organised as a general, limited or some other form of partnership and (b) does not fall within one of the other categories in this Appendix ~~B~~A. If it does not have legal personality, it may nonetheless be treated as though it were a legal person for certain purposes (for example, for insolvency purposes) and not for other purposes (for example, tax or personal liability).	No, not covered by ~~Memorandum~~our opinion.[194]	
Pension Fund. A legal entity or an arrangement without legal personality (for example, a common law trust) established to provide pension benefits to a specific class of beneficiaries, normally sponsored by an employer or group of employers. It is typically administered by one or more persons (who may be private individuals and/or corporate entities) who have various rights and obligations governed by pensions legislation. Where the arrangement does not have separate legal personality, one or more representatives of the Pension Fund (for example, a trustee of a pension scheme in the form of a common law trust) contract on behalf of the Pension Fund and are owed the rights and owe the obligations provided for in the contract and are entitled to be indemnified out of the assets comprised in the arrangement.	Yes, covered by ~~Memorandum~~ our opinion to the extent that the relevant entity is a legal entity which is an Australian Company (including that it is not an Excluded Company).	Under Australian law, superannuation ~~funds~~ entities are not legal entities. The relevant legal entity is the superannuation trustee acting in its capacity as trustee of the superannuation ~~fund~~entity. ~~As per the statement at the commencement of our Memorandum, most~~ Most superannuation trustees of Australian superannuation entities have been or are taken (by the Corporations Act) to have been registered as a company under the Corporations Act. However, to be certain as to whether such ~~a superannuation trustee~~ an entity is an Australian Company, a company search would need to be conducted as described under "Bank/Credit Institution" above. Further consideration then needs to be given to whether the entity is an Excluded Company.

[193] Consideration of the position with regard to this counterparty type requires further legal analysis and is thus outside the scope of the current opinion.

[194] Consideration of the position with regard to this counterparty type requires further legal analysis and is thus outside the scope of the current opinion.

Description	Covered by ~~Memorandum~~opinion	Legal form(s)
Sovereign. A sovereign nation state recognized internationally as such, typically acting through a direct agency or instrumentality of the central government without separate legal personality, for example, the ministry of finance, treasury or national debt office. This category does not include a State of a Federal Sovereign or other political sub-division of a sovereign nation state if the sub-division has separate legal personality (for example, a Local Authority) and it does not include any legal entity owned by a sovereign nation state (see "Sovereign-owned Entity").	No, not covered by ~~Memorandum~~our opinion.[195]	
Sovereign Wealth Fund. A legal entity, often created by a special statute and normally wholly owned by a Sovereign, established to manage assets of or on behalf of the Sovereign, which may or may not hold those assets in its own name. Such an entity is often referred to as an "investment authority". For certain Sovereigns, this function is performed by the Central Bank, however for purposes of this Appendix ~~B~~ A the term "Sovereign Wealth Fund" excludes a Central Bank.	No, not covered by ~~Memorandum~~our opinion.[196]	
Sovereign-Owned Entity. A legal entity wholly or majority-owned by a Sovereign, other than a Central Bank, or by a State of a Federal Sovereign, which may or may not benefit from any immunity enjoyed by the Sovereign or State of a Federal Sovereign from legal proceedings or execution against its assets. This category may include entities active entirely in the private sector without any specific public duties or public sector mission as well as statutory bodies with public duties (for example, a statutory body charged with regulatory responsibility over a sector of the domestic economy). This category does not include local governmental authorities (see "Local Authority").	No, not covered by ~~Memorandum~~our opinion.[197]	

[195] Consideration of the position with regard to this counterparty type requires further legal analysis and is thus outside the scope of the current opinion.
[196] Consideration of the position with regard to this counterparty type requires further legal analysis and is thus outside the scope of the current opinion.
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Description	Covered by ~~Memorandum~~opinion	Legal form(s)
State of a Federal Sovereign. The principal political sub-division of a federal Sovereign, such as Australia (for example, Queensland), Canada (for example, Ontario), Germany (for example, Nordrhein-Westfalen) or the United States of America (for example, Pennsylvania). This category does not include a Local Authority.	No, not covered by ~~Memorandum~~our opinion.[198]	

[198] Consideration of the position with regard to this counterparty type requires further legal analysis and is thus outside the scope of the current opinion.

Summary Report	
Title	**compareDocs Comparison Results**
Date & Time	07-July-2022 1:57:17 PM
Comparison Time	9.84 seconds
compareDocs version	v5.1.300.3

Sources	
Original Document	ISDA_FIA cleared legal opinion.doc
Modified Document	ISDA FIA KWM 2022.docx

Comparison Statistics	
Insertions	1322
Deletions	664
Changes	365
Moves	962
Font Changes	0
Paragraph Style Changes	0
Character Style Changes	0
TOTAL CHANGES	3313

Word Rendering Set Markup Options	
Name	KWM
Insertions	
~~Deletions~~	
Moves / ~~Moves~~	
Font Changes	
Paragraph Style Changes	
Character Style Changes	
Inserted cells	
Deleted cells	
Merged cells	
Changed lines	Mark right border.

compareDocs Settings Used	Category	Option Selected
Open Comparison Report after saving	General	Always
Report Type	Word	TrackChanges
Character Level	Word	True
Include Comments	Word	True
Include Field Codes	Word	True
Flatten Field Codes	Word	True
Include Footnotes / Endnotes	Word	True
Include Headers / Footers	Word	True
Image compare mode	Word	Insert/Delete
Include List Numbers	Word	True
Include Quotation Marks	Word	False
Show Moves	Word	True
Include Tables	Word	True
Include Text Boxes	Word	True
Show Reviewing Pane	Word	True
Summary Report	Word	End
Detail Report	Word	Separate (View Only)
Document View	Word	Print