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AUSTRALIA'S GLOBAL LAW FIRM

Banking & Finance Update

April 2013

Welcome

Welcome to the April issue of the *Banking & Finance Update*.

In this edition we look at developments, both local and international, that are impacting Australia's banking sector.

Internationally, we examine the legal risks associated with debt issuance programmes should a European Union member exit the Union.

On the local front we discuss the impact that reforms to the *Privacy Act 1988* will have on Australia's banking sector and the decision by Australia's Federal Court to approve the Nine Entertainment debt for equity swap by scheme of arrangement. We hope you enjoy this edition.

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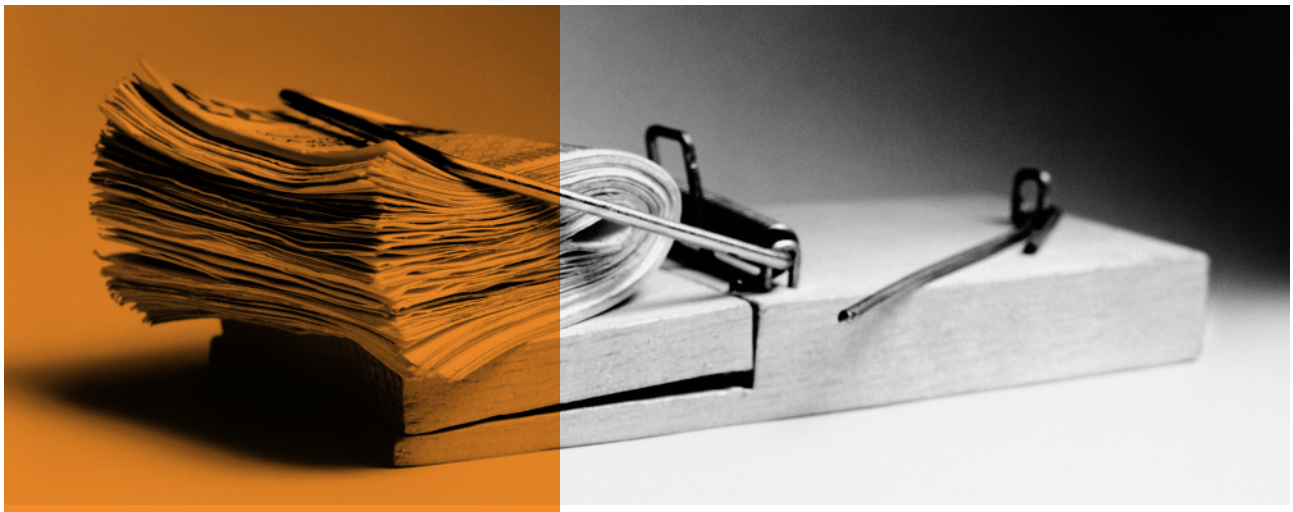

What you need to know

- Market commentators offer varying views on whether an Eurozone exit by an EU member state is actually likely (or whether an EU member state can actually do so).
- The possibility of a departure occurring gives rise to some key legal risks that Australian issuers, dealers and investors should be aware of in connection with debt issuance programmes.

What you need to do

- Market participants should consider, as a minimum, reviewing the terms and conditions of securities issued or to be issued under existing Programmes, together with the terms of relevant Programme documentation to mitigate, where possible, the likely risks.

Europe disunited – mitigation strategies for debt issuance programmes

Financial stability in Europe is likely to remain tenuous in the foreseeable future as the recent European summit failed to move the European nations towards a greater degree of fiscal federalism, with the recent Italian elections a reminder of how quickly markets react. Confidence in the decades old European collaboration will be severely tested with Britain seeking a 2015 referendum on a potential exit from the European Union ("EU"). In the words of Sir Humphrey Appleby, "[The EU] is a game played for national interests, and always was".

Whilst market commentators offer varying views on whether an Eurozone exit by an EU member state (the "Exiting State") is actually likely (or whether an EU member state can actually do so), the possibility of a departure occurring gives rise to some key legal risks Australian issuers, dealers and investors should be aware of in connection with debt issuance programmes ("Programmes"). This article gives a helicopter view of what we consider to be the key risks, and how they might be mitigated.

Key legal risks

As our London colleagues noted in their January 2012 briefing paper titled, "International contracts and the Eurozone crisis" there are a number of key legal risks. For the purposes of this overview, we have assumed a scenario of a single EU member state exiting the Eurozone, rather than a complete breakup of the Eurozone. The risks are described below.

1

Redenomination risk

Redenomination risk is the risk of whether Euro payment obligations under a debt security would be redenominated into the New National Currency of the Exiting State.

The exit by an Exiting State from the Eurozone will likely result in the passage of a domestic law establishing monetary sovereignty ("Redenomination Legislation") redenominating all debts owed by and to its nationals from the Euro into a new currency ("New National Currency"), without EU consensus or over-arching EU legislation.

A corollary to an Exiting State's new monetary sovereignty would be rapid depreciation in the exchange rate of the New National Currency against the Euro. This, in turn, could cause significant currency risk to market participants holding existing debt securities.

2

Continuity of contract risk

Continuity of contract risk is the impact on the validity of existing contracts (in this case, the terms and conditions of debt securities or other Programme documents) and associated risks.

In particular, it is questionable whether contractual payments would be automatically discharged for frustration (in the event that a Euro-based price source or Euro reference rate were either no longer available or due to the imposition of exchange controls likely to be introduced by the Exiting State in conjunction with its Redenomination Legislation) and whether certain contractual terms could be triggered (including, but not limited to illegality, force majeure, material adverse change and events of default).

3

Basis risk

Basis risk is the consequences arising where a debt security (ie, its coupon or redemption amount – in the Australian market, for example this may include a warrant) is linked to a reference asset or price source which is denominated in or based on Euro and which is either no longer appropriate where an instrument redenominates into a New National Currency or redenominated (eg, into reference shares or indices).

4

Exchange control risk

There is a risk that, while an Australian court may uphold the validity of Euro-denominated payments under the terms of a debt security, those payments may be unenforceable or otherwise blocked by exchange controls likely to be introduced by the Exiting State in conjunction with its Redenomination Legislation.

5

Enforcement risk

Enforcement risk is the risk that a judgment obtained in an Australian court would not be able to be enforced in an Exiting State in Euro.

6

Amendment risk

More a difficulty than a risk – the issue is that it may be difficult, if not impossible, in practice to amend the terms of existing debt securities (particularly those that are widely held).

Possible mitigation strategies

In light of the above risks (and mindful that there are many variables that might arise in the context of an EU member state exiting the Eurozone), market participants should consider, as a minimum, reviewing the terms and conditions of securities ("Securities") issued or to be issued under existing Programmes, together with the terms of relevant Programme documentation to mitigate, where possible, the above risks.

1 Governing law and jurisdiction

The governing law of the debt securities and the Programme documentation should be the laws of an Australian State or Territory, English law, New York law or some other law other than that of an "at risk" member state. Similarly, jurisdiction should be specified so as to correspond to the chosen governing law, on an exclusive basis.

A complication arises in Programmes where guarantees are involved. Prudent drafting would sequester the guarantor's payment obligation in Euros only. As a practical matter, however, this may be difficult to enforce where the guarantor is located within an Exiting State and its revenues are derived in the New National Currency.

2 Definition of "Euro"

"Euro" should not be defined as the lawful currency of the Existing State as such a definition would incorporate any replacement currency introduced from time to time. Rather "Euro" should be more broadly defined as the single currency of the EU. An example may be:

> ""Euro" means the lawful single currency of the member states of the European Union that have adopted and continue to retain a common single currency through monetary union in accordance with European Union treaty law (as amended from time to time)."

3 Place of payment

The place of payment should not be designated as a city in an "at risk" member state. Drafting the place of payment to that effect will rebut any presumptions that may arise should a court be required to enquire as to what the underlying payment currency should be, where the currency definition may be insufficiently defined.

Additionally, the definition of "Business Day", as it applies to the required payments, should also only refer to a city that is not in an "at risk" member state.

4 Include terms permitting termination and/or adjustments on a Eurozone exit

Parties may wish to consider including the following possible terms and guidance:

- **Illegality, material adverse effect and force majeure:** Ensuring these terms are wide enough to cover a Eurozone exit.
- **Early termination/adjustment clauses:** Adding clauses to permit early termination (including call or put options) or adjustment to the terms of securities/Programme documents to preserve the commercial terms on a good faith and commercially reasonable basis, subject to applicable laws.
- **Trade body guidance:** Conforming to proposed market standard terms and protocols (eg, AFMA or ICMA).
- **Further disclosure in offering documentation:** Whilst questionable whether the risk is too remote for disclosure purposes, where risk factors are required to be included in offering documents for Programmes, consideration should be given as to the inclusion of an appropriate risk factor.

It may be impossible to predict when, and how, economic recovery will occur. Fears of member states withdrawing from the EU may even be unfounded and close to an impossibility as the exiting member would undoubtedly experience currency devaluation and crippling inflation. Nonetheless, market participants should act prudently should that eventuality precipitate.

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Privacy reforms will affect the banking industry

What you need to know

- New privacy principles and new laws regulating the handling of credit information will come into effect on 13 March 2014 as a consequence of amendments to the *Privacy Act 1988* (Cth), which were passed in November 2012.

What you need to do

- Accordingly it is essential that all organisations review their policies and practices to ensure compliance with the new privacy principles. Organisations in the business of providing credit need also to familiarise themselves with the revamped regime governing the use and disclosure of credit reporting information.

New privacy principles and new laws regulating the handling of credit information will come into effect on 13 March 2014 as a consequence of amendments to the *Privacy Act 1988* (Cth), which were passed in November 2012.

Background to Privacy Act

The *Privacy Act 1988* commenced on 1 January 1989. It was initially introduced as cognate legislation to the *Taxation Laws Amendment (Tax File Numbers) Act 1988* to regulate the use of tax file number information, whilst simultaneously imposing a set of Information Privacy Principles on Commonwealth government agencies.

On 25 September 1991, the Act was amended so as to regulate the practices of credit reporting agencies and credit providers in relation to personal credit information.

Under amendments introduced by the *Privacy Amendment (Private Sector) Act 2000*, which commenced on 21 December 2001, National Privacy Principles were introduced to regulate privacy in the private sector.

State and Territory data protection laws also exist in most jurisdictions. They regulate the handling of personal information by the State or Territory public sector and are not of direct application to Australia's banking industry.

Key elements of existing data protection regime

The *Privacy Act* primarily regulates the handling of personal information. In addition, it specifically addresses the handling of tax file numbers and credit information.

The Act provides that tax file number recipients must not do an act or engage in a practice which breaches the guidelines relating to tax file number information: section 18. The current guidelines were issued in 1992 and have been amended on a number of occasions.

The relevant regulation of credit reporting agencies and credit providers in relation to personal credit information is set out in Part IIIA. In addition, section 18A requires the introduction of a *Code of Conduct* relating to credit information files, and credit reports, to be issued by the Privacy Commissioner.

Key exemptions

There are some significant exemptions to the current operation of the *Privacy Act*.

Under clause 7B(1) of the *Privacy Act*, an act done, or practice engaged in, by an individual is exempt if the act is done, or the practice is engaged in, other than in the course of a business carried on by the individual.

Businesses with an annual turnover of $3 million or less are, with some exceptions, totally exempt from the *Privacy Act*: section 6C.

An organisation is not required to comply with the *Privacy Act* in relation to the handling of "employee records" in matters directly related to a current or former employment relationship: section 7B(3).

Australia's dual privacy principles

Different rules apply to the public sector and the private sector.

The Commonwealth public sector is required to comply with the Information Privacy Principles set out in section 14, and the private sector is required to comply with the National Privacy Principles set out in schedule 3.

Restrictions on trans border data flows

A significant restriction imposed on the private sector, but not the public sector, relates to trans border data flows.

National Privacy Principle 9 places restrictions on the ability of private sector organisations to transfer personal information to a foreign country. Private sector overseas transfers are only permissible if certain conditions are met.

Background to the reform process

As a consequence of the inefficiencies arising out of the dual regulation of the public and private sectors and some of the incongruous exemptions, together with the fact that the legislation has been amended in in a piecemeal fashion over a period of 25 years, the federal government issued terms of reference to the Australian Law Reform Commission on 30 January 2006 to undertake a comprehensive review of the *Privacy Act 1988*.

The ALRC issued its report in 2008, and this culminated in the passage of the *Privacy Amendment (Enhancing Privacy Protection) Act 2012* (Cth) on 29 November 2012 (the "*Privacy Amendment Act*"). The key provisions of the legislation will not, however, come into effect until 13 March 2014, being 15 months after the date of Royal Assent.

New Australian privacy principles

As recommended by the ALRC, the Amendment Act amalgamates and refines the existing Information Privacy Principles and National Privacy Principles to create a single set of principles, to be known as the Australian Privacy Principles, which will regulate both Commonwealth agencies and private sector organisations.

The APPs are contained in five parts:

- **Part 1** – Principles dealing with the management of personal information (APP 1, APP 2);
- **Part 2** – Principles dealing with the collection of personal information (APP 3, APP 4, APP 5);
- **Part 3** – Principles dealing with the use and disclosure of personal information (including direct marketing and cross-border disclosure) (APP 6, APP 7, APP 8, APP 9);
- **Part 4** – Principles dealing with the integrity, quality and security of personal information (APP 10, APP 11);
- **Part 5** – Principles dealing with request for access to, in correction of, personal information (APP 12, APP 13).

The new APPs need to be read subject, in particular, to sections 16A, 16B and 16C.

Section 16A creates the concept of a "permitted general situation" which stipulates, in a positive sense, those activities in which an entity might engage which will be deemed not to breach the privacy of an individual.

Various "permitted general situations" are listed in a table, and include circumstances such as the prevention of a serious threat to life or safety, the defence of a legal claim and various national interest scenarios.

Section 16B addresses the concept of a "permitted health situation", being circumstances in which the collection by an organisation of health information about an individual will be permissible and will be deemed not to breach the privacy of the individual.

Section 16C deals with the acts and practices of overseas recipients of personal information. The section is directly relevant to the ongoing accountability of a discloser in the context of cross-border data flows under APP 8 and it stipulates that if APP 8.1 applies to a disclosure (that is, in effect, if information is transferred overseas without the consent of the individual to a destination where there is no data protection law equivalent to Australia's), then the discloser is held accountable for any privacy breach committed by the recipient.

New credit reporting provisions

Schedule 2 of the Privacy Amendment Act amends the credit reporting provisions contained in Part IIIA. Consistent with the ALRC's recommendations, the amendments permit more comprehensive credit reporting processes. Additional types of information may be incorporated into credit reports, namely:

- the date a credit account was open;
- the type of credit account opened;
- the date the credit account was closed;
- the current limit of each open credit account;
- repayment performance history about the individual (available to credit providers who are licensees under Chapter 3 of the *National Consumer Credit Protection Act* or prescribed by the Regulations and mortgage insurers).

The Act also introduces a provision relating to the disclosure of credit information to certain persons or bodies that do not have an Australian link.

In broad terms, Part IIIA is restructured along the following lines:

- **Division 1** contains an introduction and guide;
- **Divisions 2 and 3** contain rules that apply to credit reporting bodies and credit providers in relation to their handling of information relating to credit reporting;
- **Division 4** contains rules that apply to affected information recipients in relation to their handling of their regulated information;
- **Division 5** deals with complaints to credit reporting bodies or credit providers about acts or practices that may be a breach of the legislative requirements;
- **Division 6** deals with entities that obtain credit reporting information or credit eligibility information by false pretence, or where not authorised to do so;
- **Division 7** provides for compensation orders, and other orders, to be made by the Federal Court or the Federal Circuit Court.

New powers for the Privacy Commissioner

The legislation is accompanied by increased powers of investigation for the Privacy Commissioner together with civil penalties of up to $1,700,000 for corporations.

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Federal Court approves Nine Entertainment debt for equity swap

What you need to know

- The Federal Court of Australia has approved a debt for equity swap to convert the senior and mezzanine secured debt of Nine Entertainment to equity notwithstanding some opposition from minority senior lenders on the grounds that they should not be compelled to do so in place of their secured debt.
- To the extent that there was any doubt about the ability of an Australian court to scheme dissenting secured lenders, this doubt has been resolved by the decision of Jacobson J to approve the Nine scheme which has the effect of converting all of the debts and security rights of senior and mezzanine creditors to equity as part of the restructuring of the company; see *Nine Entertainment Group Limited, in the matter of Nine Entertainment Group Limited (No1) [2012]* FCA 1464.
- As such, secured lenders in Australian syndicates remain liable to be schemed into equity if 75% or more of lenders by value and a majority in number vote in favour of the scheme.

Implications of the decision

Australia remains one of the most secured creditor friendly jurisdictions in the world. Australia's insolvency rules continue to provide virtually unfettered priority and enforcement rights to secured creditors with enforceable charges over all or substantially all of the assets of the debtor under both the voluntary administration and liquidation regimes. This system of strong secured creditors' rights is to be contrasted with the Chapter 11 procedure in the United States and indeed, certain features of the UK Insolvency Act which substantially restricts the rights of secured lenders to pursue non-collective insolvency procedures.

The Australian insolvency system has traditionally protected the enforcement and priority rights of secured creditors unless they agree to vary them. Even the Alinta and Centro schemes of arrangement can be characterised as, in substance, consensual arrangements rather than arrangements approved in the face of opposition from senior lenders. As such, the Nine scheme of arrangement represents the first time that a court has decided that secured lenders to an Australian company can be compelled to accept equity in the face of their opposition.

The approval of the Nine scheme by the Court highlights that these principles are subject to an important exception, namely; that if the majority of creditors holding 75% or more of the debt under a syndicated lending structure vote in favour of the scheme, the minority lenders are liable to be schemed to accept equity in the debtor. This is, of course, the position in the UK and has been so for some time.

Grounds of opposition

A number of the original lenders to Nine objected to the proposed scheme at the first hearing on two principal grounds; namely:

- that section 231 of the *Corporations Act 2001* (Cth) (the "Act") prohibited the allocation of shares to a person without their express or implied consent; and
- that the scheme classes had not been properly constituted by reason of certain director appointment rights attaching to creditors holding less than 50% of the senior debt in Nine.

In response to these objections, Jacobson J found as follows:

- section 411 of the Act empowers a court to override the effect of section 231 of the Act and that secured lenders may be required to accept shares in the company in full satisfaction of their claims as creditors; and
- the director appointment rights enjoyed by some of the senior lenders did not create new or additional rights which made it impossible for the senior lenders to consult together about the scheme at the scheme meeting (which is the traditional class test).

Accordingly, his Honour convened the scheme meetings at which the scheme was approved by the requisite majority.

The scheme has now received the final approval of the Court at the second scheme hearing on 29 January 2013.

Although it was open to do so, no secured creditor opposed the scheme at the second hearing on fairness grounds. Such an objection of course remains open to dissenting lenders if there is some specific factual basis to make that case, particularly if lenders disagree with the valuation adopted by the scheme. For an example of an unsuccessful challenge by mezzanine lenders to the senior lender valuation adopted for a UK scheme, see *Bluebrook Ltd, Re* [2009] EWHC 2114 (Ch), [2010] BCC 209 (more commonly known as the *IMO* decision).

Conclusion and implications

The Nine scheme is an important milestone in the history of the Australian restructuring market.

The decision is positive for debtors looking to promote schemes to reconstruct their balance sheets whilst avoiding formal insolvency appointments. The decision also supports the continuing development of the secondary debt markets in Australia as banks will elect to sell debt rather than risk being schemed into equity which they do not wish to hold. For funds buying into that debt, it promotes their ability to override the objections of minority lenders in order to achieve their restructuring and control objectives.

Traditional secured lenders are expected to look at the decision less favourably on the basis that it detracts from the otherwise strong protection afforded to the rights of secured lenders in Australia. No doubt some effort will be undertaken in future leveraged deals to structure around scheme risk if that is possible. Of course the best protection is either bilateral arrangements or holding sufficient of the debt to block any scheme proposal.

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