The Acquisition and Leveraged Finance Review

Ninth Edition

Editor
Fernando Colomina

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THE ACQUISITION AND LEVERAGED FINANCE REVIEW

NINTH EDITION

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PREFACE

Market conditions have remained challenging through the past year. The post-pandemic recovery globally saw a significant setback as a result of the war in Ukraine, which exacerbated the pre-existing market issues and led to historic policy actions and moves across global markets. US inflation saw a cool-down from a second-quarter peak as the Fed turned to aggressive tightening on the market, risking triggering a recession in the US economy. Eurozone inflation accelerated through the year, reaching record double digits in the third quarter as power suppliers looked for alternative sources amidst soaring energy prices. Governments have been forced to intervene, with energy price caps announced to protect households through the winter. Further rate rises will be expected at European Central Bank policy meetings to tame inflation and restore price stability as recession risks grow.

In tandem with these challenges, the acquisition and leveraged finance industry saw primary issuance slow down significantly, with declines of almost 50 per cent in the first half of the year from record highs in the same period in 2021. Market conditions particularly deteriorated throughout the second quarter as we saw the credit markets take an early summer break. One bright spot, accounting for the largest portion of European buyout activity, was the volume of add-ons in popular defensive sectors such as B2B and IT, as financial sponsors looked to build up portfolio companies through the uncertainty.

Traditional lenders have been cautious about underwriting buyouts in this environment as spreads have widened. Financial sponsors across Europe have consequently considered private debt funds as a viable alternative to the syndicated markets. This year, they have played a more prominent role in larger buyout financings across sectors, with several funds sharing the risk. There are, however, signs that private debt funds are becoming more selective and looking to safer sectors that are less cyclical and protected from supply-chain issues. We would expect to see an increase in pricing on financing packages with less leverage and a demand in stronger protection and more-conservative terms.

As we enter 2023, macroeconomic conditions in Europe in a tighter policy environment are likely to remain challenging in the first half of the year. There will be an increase in liability management transactions, restructurings and distress-related M&A across more cyclical, capital-intensive sectors and highly indebted buyouts. But down markets and recessions provide good buying opportunities. With European equity prices likely to remain at relatively low and attractive levels, take-private transactions will continue to be an attractive source of deal flow. The strengthening US dollar also creates an opportunity for financial sponsors to take advantage of an attractive FX rate, particularly if the businesses are resistant to inflation or provide counter-cyclical business hedges.

Many thanks to everybody who has participated in this publication, and a special thank you to Law Business Research.

We sincerely hope that this edition of *The Acquisition and Leveraged Finance Review* will be of assistance to you in this challenging era.

Fernando Colomina
Latham & Watkins
Madrid
November 2022

Chapter 1

AUSTRALIA

John Schembri and Erin Cartledge[1]

I OVERVIEW

Australia has a long history of merger and acquisition activity, and consequently the debt financing of these acquisitions is a well-trodden path for lenders and borrowers alike. Traditionally, the senior debt financing of acquisitions in Australia has been the domain of the banks, international and domestic, with the local 'Big Four' banks often taking lead roles in relation to the arranging and underwriting of these facilities. However, consistent with the European experience, the market has recently borne witness to the emergence and proliferation of non-bank, institutional lenders.

Traditionally, an Australian acquisition finance package will feature an amortising term loan A, together with a bullet term loan B, to fund the acquisition of the target group. These facilities will generally be accompanied by a *pari passu* revolving facility that is designed to meet the target's working capital or contingent instrument needs, or both, post-acquisition. Capital expenditure or acquisition facilities are often also included as required (generally on a committed basis). Subordinated debt provided by specialised institutions (usually in the form of mezzanine loans or local capital markets products) also often features where the acquisition is of a sufficient size. Recently, there has been a trend for mezzanine funding to be provided at a level above the bank group, being the holdco level. This enables sponsors and senior lenders to avoid much of the complexity that comes from having this subordinated debt provided at (or just above) the level of the senior debt. As a general rule, loan documentation in the Australian market is relatively standardised, thus enabling loans to be drafted, priced and syndicated to a wide pool of financiers.

Unitranche loans (a hybrid loan that rolls senior and subordinated debt into a single debt instrument) remain popular, particularly on the basis that they are nimble, flexible (from a covenant perspective) and relatively easy to execute.

1 John Schembri is a partner and Erin Cartledge is a senior lawyer at Gilbert + Tobin. The authors would like to thank Alex Kauye, Peter Bowden, Anna Ryan, Mark Nichol, Catrina Chen, Deborah Johns, Julian Cheng, Peter Hession, Alina Sedmak and Hanh Chau for their assistance with the preparation of this chapter.

II REGULATORY AND TAX MATTERS

i Regulation of foreign investments in Australia

The Australian Foreign Acquisitions and Takeovers Act 1975 (Cth) (FATA) and its associated regulations (administered by the Foreign Investment Review Board (FIRB)) regulate the making of investments by foreign persons in Australian companies and assets (and in some cases offshore companies with the requisite Australian connection).

In general, the legislation regulates four kinds of actions: significant actions, notifiable actions, notifiable national security actions and reviewable national security actions.

Significant or notifiable action

The Treasurer has the power to make orders in relation to significant actions (including blocking them, ordering divestments, or imposing conditions) if he or she considers the transaction to be contrary to the national interest. Approval only has to be sought for these if they are also notifiable actions or notifiable national security actions, but obtaining approval cuts off the Treasurer's powers (although he or she can in certain circumstances re-open approvals). Seeking approval is strongly advised. Notifiable actions are a category of transaction that requires approval. Most notifiable actions are also significant actions (meaning the Treasurer has the above powers).

Common significant, or significant and notifiable, actions are:

a the acquisition of 20 per cent or more of an Australian entity that is valued above the current monetary thresholds (currently A$289 million, or A$1,250 million where a higher treaty threshold can be relied on, and the business is not a sensitive business);

b the acquisition by a foreign person that is a foreign government investor of 10 per cent or more (and sometimes less than 10 per cent) of an Australian entity or business (subject to a *de minimis* exemption, where the acquisition is of an offshore entity with an Australian subsidiary that meets certain tests);

c the acquisition of 10 per cent or more (and sometimes less than 10 per cent) of an Australian entity that carries on an agribusiness where the investment is valued above the then current monetary threshold;

d the acquisition of an interest in land valued above the then current monetary threshold (which varies depending on the kind of land and who the acquirer is), unless an exception applies; and

e the acquisition of 5 per cent or more of an Australian media business.

A foreign government investor (FGI) in general includes a foreign government or agency, sovereign wealth funds, state-owned enterprises, public pension funds, public universities and the like, or corporations, trustees of trusts or general partners of limited partnerships where, in respect of the corporation, trust or limited partnership:

a FGIs from one country hold 20 per cent of the interests; or

b FGIs from multiple countries hold 40 per cent or more of the interests, subject to an exception for passive investors (which does not apply to the 20 per cent limb).

Many PE funds are FGIs because of the amount of US state pension fund money in them.

Notifiable national security action

The Treasurer has the power to make orders in relation to notifiable national security actions (including blocking them, or ordering divestments) if he or she considers the transaction to be contrary to national security (which is narrower than the national interest test above). These actions require approval. An action is a notifiable national security action if the action is taken, or proposed to be taken, by a foreign person and the action is any of the following:

a starting a national security business;

b acquiring an interest of 10 per cent or more (and in some cases less than 10 per cent) in a national security business;

c acquiring an interest of 10 per cent or more (and in some cases less than 10 per cent) in an entity that carries on a national security business;

d acquiring an interest in Australian land that, at the time of acquisition, is national security land; or

e acquiring a legal or equitable interest in an exploration tenement in respect of Australian land that, at the time of acquisition, is national security land.

A national security business is one that is carried on wholly or partly in Australia whether or not for profit or gain and is publicly known, or could be known after reasonable enquiry, that the business:

a is a responsible entity or direct interest holder of critical infrastructure assets as defined in the Security of Critical Infrastructure Act 2018 (this covers 22 different kinds of critical infrastructure assets, including: (1) aviation, (2) banking, (3) broadcasting, (4) data storage or processing, (5) defence industry, (6) domain name system, (7) education, (8) electricity, (9) energy markets, (10) financial market infrastructure, (11) food and grocery, (12) freight infrastructure, (13) freight services, (14) gas, (15) hospitals, (16) insurance, (17) liquid fuel asset, (18) port, (19) public transport, (20) superannuation, (21) telecommunications and (22) water and sewerage);

b is a carrier or nominated carriage service provider to which the Telecommunications Act 1997 applies;

c develops, manufactures or supplies critical goods or critical technology that are for military or intelligence use by Australian or foreign defence or intelligence agencies;

d provides critical services to Australian or foreign defence or intelligence agencies;

e stores or has access to information that has a security classification;

f stores or maintains personal information of Australian defence and intelligence personnel collected by the Australian Defence Force, the Defence Department or an agency in the national intelligence community, which, if accessed, could compromise Australia's national security;

g collects, as part of an arrangement with the Australian Defence Force, the Defence Department or an agency in the national intelligence community, personal information on defence and intelligence personnel, which, if disclosed, could compromise Australia's national security; or

h stores, maintains or has access to personal information as specified in the above dot point, which, if disclosed, could compromise Australia's national security.

National security land is any of the following that is in Australia, and is owned or occupied by the Commonwealth for use by the Defence Force or the Department of Defence:

a an area of land or any other place (whether or not it is enclosed or built on);

b a building or other structure;
c a prohibited area, within the meaning of the Defence (Special Undertakings) Act 1952; and
d the Woomera Prohibited Area.

It also includes land in which the Commonwealth, as represented by an agency in the national intelligence community, has an interest that:
a is publicly known; or
b could be known upon the making of reasonable inquiries.

Reviewable national security action

Reviewable national security actions are transactions with an Australian nexus that are not significant actions, notifiable actions or notifiable national security actions. These transactions, together with significant actions for which approval is not sought, are subject to the Treasurer's 'call in' powers for a period of 10 years if he or she considers that the transaction poses a national security concern. Like significant actions, reviewable national security actions do not have to be notified, but obtaining approval cuts off the Treasurer's powers (although he or she can in certain circumstances re-open approvals). The Australian government encourages seeking approval for certain kinds of reviewable national security actions.

While FIRB approval is principally a matter of concern from an M&A perspective (where ownership in the shares or assets are actually being transferred), it is also relevant in a debt finance context given that 'obtaining an interest' also extends to the grant of a security interest over such shares or assets or the enforcement of such security.

In a finance context, there is an exception from this requirement if the interest is either held by way of a security or acquired by way of enforcement of a security, solely for the purpose of a money-lending agreement. This applies to persons whose ordinary business includes the lending of money (which is deliberately broad enough to capture institutions that are not authorised deposit-taking institutions (ADIs) and also captures a subsidiary or holding company of such a lender, a security trustee or agent, and a receiver or receiver and manager of an entity that holds or acquires the interest). This exception also applies to a 'foreign government investor', although in respect of an interest acquired by way of enforcement of a security, a foreign government investor is restricted in the amount of time it can hold an asset (12 months in the case of an ADI and six months in the case of a non-ADI, unless the foreign government investor is making a genuine attempt to sell the assets acquired by way of enforcement). The money-lending exception has more limited application where the security is over residential land, national security land or a national security business.

Where the acquisition is not politically sensitive, these approvals are generally provided as a matter of course, although the need for FIRB approval should be considered where security is being granted over material Australian entities and the imposition of conditions around tax, data handling and the like is becoming routine.

Other government approvals can also be required to take security over certain types of assets (such as mining and resource interests) that are subject to separate regulation.

Note that the above is a summary only. Australia's foreign investment rules are notoriously complex and are affected by non-statutory guidance, and legal advice should always be sought.

ii Interest withholding tax

Interest withholding tax (IWT) of 10 per cent applies on gross payments of interest (or payments in the nature of, or in substitution for, interest) made by Australian borrowers to non-resident lenders (except where the lender is acting through an Australian permanent establishment or where other exceptions apply). IWT is a final tax and can be reduced (including to zero) by domestic exemptions, such as the public offer exemption, and the operation of Australia's network of double tax agreements (DTAs).

Under DTAs with Finland, France, Germany, Japan, New Zealand, Norway, South Africa, Switzerland, the United Kingdom and the United States, there is no IWT for interest derived by a financial institution unrelated to, and dealing wholly independently with, the borrower (subject to certain exceptions).

Under Australian domestic law, IWT may also be exempt where the debt satisfies the 'public offer' exemption (contained in Section 128F of the Income Tax Assessment Act 1936 (Cth)). Once the debt satisfies the public offer exemption, it is typically more marketable as an incoming lender remains entitled to the benefits of the exemption from IWT (subject to certain criteria being met). Broadly, the public offer exemption applies where an Australian company (or eligible unit trusts in certain circumstances) publicly offers certain debt instruments via one of several prescribed means, including (most commonly):

- *a* the debt instrument is offered to at least 10 persons, each of whom is carrying on a business of providing finance, or investing or dealing in securities in the course of operating in financial markets, provided each of those persons are not known or suspected by the borrower to be an associate of any of the other persons; or
- *b* the debt instrument is offered to the public in an electronic form that is used by financial markets for dealing in debentures or debt interests.

The type of debt that may qualify for the public offer exemption consists, broadly, of debentures (which are defined to include notes) and syndicated facility agreements.

If the debt instrument is in the form of a syndicated facility agreements, it can only benefit from the public offer exemption if additional conditions are satisfied, including (among other criteria) that:

- *a* there are two or more lenders where each lender severally, but not jointly, agrees to lend money (or otherwise provide financial accommodation);
- *b* the agreement describes itself as a 'syndicated loan facility' or 'syndicated facility agreement'; and
- *c* where the borrowers will have access to at least A$100 million at the time the first loan or other form of financial accommodation is provided.

An IWT exemption is not available where the issuer (or arranger acting as agent for the issuer) knew or had reasonable grounds to suspect that the debt instrument will be acquired by an associate of the Australian borrower: (1) who is a non-resident and the debenture or debt interest was not or would not be acquired by the associate in carrying on business through a permanent establishment in Australia; or (2) who is a resident and the debenture or debt interest was or would be acquired by the associate in carrying on business through a permanent establishment in a country outside Australia, unless the associate acquired it in the capacity of a dealer, manager or underwriter in relation to the placement of the debt instrument, or a clearing house, custodian, funds manager or responsible entity of a registered scheme.

IWT relief also applies to certain foreign pension funds and sovereign funds. The IWT exemption will only apply to foreign pension and sovereign funds with (broadly) portfolio-like interests in the borrower, being interests in an entity that are less than 10 per cent of total ownership interests and do not carry an ability to influence the entity's decision-making. Additionally, the IWT exemption for sovereign funds will only be available for returns on investments in Australian resident companies and managed investment trusts.

iii Thin capitalisation

Australia has a thin-capitalisation regime that can operate to deny income tax deductions for interest expenditure on overly geared Australian groups that have debt deductions over the *de minimis* threshold of A$2 million for an income year. There are three methods to calculate the maximum allowable debt of a taxpayer. Most Australian borrowers will rely on the safe harbour, which in broad terms allows for Australian assets to be funded by up to 60 per cent debt. In the context of an acquisition, these provisions allow for the funding of acquired goodwill.

In addition, there is an arm's-length debt test, which broadly allows Australian groups to be debt-funded up to the maximum amount a third-party lender would be willing to lend (based on certain assumptions). This test has not typically been used as it is an annual test that requires an assessment of various quantitative and qualitative factors including the prevailing debt markets and general state of the Australian economy. Another test, the worldwide gearing test, allows an eligible entity to gear its Australian operations, in certain circumstances by reference to the gearing level of its worldwide group.

The recently elected Australian government proposes to replace the existing safe harbour and to instead limit interest deductions for an income year to 30 per cent of earnings before interest, taxes, depreciation and amortisation. Limited detail is currently available on the proposed measure, which is intended to take effect from 1 July 2023 (if enacted).

III SECURITY AND GUARANTEES

i Common security packages

The Personal Property Securities Act 2009 (Cth) (PPSA) sets out the principles applicable to the grant and perfection of security interests in Australia, principles that should be relatively familiar to anyone who has had experience in a common law jurisdiction.

The PPSA introduced a uniform concept of a 'security interest' to cover all existing concepts of security interests, including certain mortgages, charges, pledges and liens. It applies primarily to security interests in personal property that arise from a consensual transaction that, in substance, secures payment or performance of an obligation. It also applies to certain categories of deemed security interests, so that like transactions will be treated alike. 'Personal property' is broadly defined and essentially includes all property other than land, fixtures and buildings attached to land, water rights and certain statutory licences.

In a typical domestic secured lending scenario, security is most commonly taken by the relevant security providers entering into a general security deed which covers all of the relevant security providers' assets and undertakings (the local equivalent of a debenture). Such an instrument can attach to all forms of 'personal property' (both tangible and intangible) and operates in a similar way to a debenture or security agreement. Accordingly, all-asset security can be obtained from corporate grantors simply and effectively.

In an acquisition context, the general security deed is often supplemented, where necessary, by a specific security deed over the shares of an Australian target (i.e., a share mortgage) granted by its special purpose vehicle or offshore parent. This is often a necessary part of the security structuring where restrictions on the provision of financial assistance (dealt with further below) mean that direct target security cannot be obtained on closing the acquisition. In each case, these security interests are supported by corporate guarantees, which are typically documented in the credit agreement.

To ensure priority and perfection, each of these security interests must be registered on the Personal Property Securities Register (PPSR), created under the PPSA, within 20 business days of the security agreement that gave rise to the security interest coming into force (with some forms of security interest requiring registration within a shorter timeframe, including on or prior to the date that the security interest is granted by the security provider). It is possible for the secured party to register a security interest on the PPSR on and from the time that the secured party believes, on reasonable grounds, it is (or will be) a secured party in relation to the collateral. While not mandatory, registration will generally ensure that the security interest retains its priority against subsequently registered interests and that it remains effective in the event of the insolvency of a corporate security provider. It is possible (and advisable) for lenders to search the PPSR to determine whether there are any prior security interests registered against the relevant entities in the structure (including the Australian-domiciled holding companies and targets, together with any offshore parents of these entities).

Security can be granted over real property (both freehold and leasehold) by way of a registered real property mortgage. Such security is only generally sought where the real property in question has operational or economic significance. Unlike security interests that are dealt with under the PPSA, the grant of security over real property is dealt with on a state-by-state basis. However, from a practical perspective, there are few fundamental differences between the regimes in the various states. As with personal property and PPSR searches, the relevant land registries can, and should, be searched to determine what encumbrances or restrictions on title have been registered against the relevant property.

ii Issues with the grant of security

Financial assistance

Section 260A of the Corporations Act 2001 (Cth) (Corporations Act) imposes restrictions on a company providing financial assistance for the acquisition of its, or its holding companies', shares. Financial assistance includes not only the granting of security, but also the provision of guarantees and indemnities (among other things). While a transaction that breaches this restriction is not invalid, any person involved in the contravention of this provision may be found guilty of a civil offence and subject to civil penalties. This liability can be criminal where a person is dishonestly involved in a breach. This liability (both civil and criminal) can theoretically extend to the lenders.

The general prohibition on the provision of financial assistance is subject to certain exceptions. The most commonly utilised exception is the exception set out in Section 260A(1)(b) of the Corporations Act (colloquially known as the 'whitewash' process), which enables the shareholders of the company to approve the proposed financial assistance. Given that an acquisition financing will invariably involve the grant of target security, the financial assistance rules are particularly relevant to this form of financing. For this reason, security over Australian target entities is generally granted within an agreed period post-closing (typically no less than 30 days) following the completion of the 'whitewash'. That said, this restriction does not affect the grant of security by any Australian-incorporated special purpose holding company, or any offshore parent over its shares in an Australian-domiciled entity, which can be provided in a more timely fashion.

Corporate benefit

Under Australian law, directors owe a number of duties to the companies to which they have been appointed. These duties are enshrined in the Corporations Act, as well as arising under general law, and include a fiduciary duty to act in good faith in the best interests of the company. In a secured lending context, these duties often come under scrutiny in circumstances where a subsidiary is asked to guarantee the debts of its parent or sister companies within the same corporate group. Where the party obtaining the benefit of a guarantee or security knows or ought to know that the directors have not acted in the best interests of the company in providing such credit support, the guarantee or security will be voidable against that party. For wholly owned subsidiaries that are considering guaranteeing the debt obligations of their parent, the above duties are often viewed in light of Section 187 of the Corporations Act, which enables a wholly owned subsidiary to adopt a provision in its constitution enabling it to act in the best interests of its holding company (and in so doing, will be deemed to be acting in the best interests of the company itself). Where Section 187 of the Corporations Act is not available, care should be exercised to ensure that the corporate security provider derives some benefit from granting the guarantee or security and that granting the guarantee or security is in the best interests of the corporate security provider.

A guarantee or security could be set aside by a court if that court finds that the directors of the security provider have breached their duties and the lender was aware of that breach.

Administration risk

'Administration risk' describes the risk for a secured party that its security becomes subject to a moratorium if an administrator is appointed to a corporate security provider (which the directors of that entity are likely to do if the company is or is likely to become insolvent). Subject to the consent of the administrator or court order, a secured party is not entitled to enforce its security during the moratorium. This will be the case unless one of the exceptions apply, with the key exception being where the secured party has taken security over all, or substantially all, of the company's assets and the secured party has enforced its security interest within the 'decision period'. The 'decision period' runs for 13 business days from the date the secured party was given notice of the appointment of an administrator or the date that the administration begins.

Due to the above, a secured party who holds perfected security over only certain assets (and those assets alone do not comprise all, or substantially all, of the company's assets) will not be able to enforce its security during the moratorium. To address this risk where the primary collateral is limited to specific assets, a 'featherweight' security interest may be taken over all of the grantor's assets (other than the principal secured property) that secures a nominal sum.

Stamp duty

Mortgage duty is no longer payable in any Australian jurisdiction. Further, while *ad valorem* duty is generally not payable on financing transactions, nominal duty will be payable on a finance document that contains a provision which effects or evidences a declaration of trust over non-dutiable property, and that document has been executed by any party in New South Wales or Victoria.

iii Australian insolvency regime and its impact on the grant of security

The Australian insolvency regime is codified in the Corporations Act and its associated regulations, and contains a number of provisions that can potentially affect the rights of a creditor of an Australian entity.

Under Australian law, transactions will only be vulnerable to challenge when a company does, in fact, enter into liquidation. Division 2 of Part 5.7B of the Corporations Act provides that a liquidator can bring an application to the court to declare certain transactions void. While an administrator is required, in its statutory report to creditors, to identify potential voidable transactions that may be recoverable by liquidator (if appointed), the administrator does not have standing to challenge these transactions.

There are several types of transactions that can be found to be voidable:

a unreasonable director-related transactions;

b unfair preferences;

c uncommercial transactions;

d unfair loans; and

e creditor-defeating dispositions (often associated with illegal 'phoenixing' activity).

Except for transactions entered into by companies in voluntary administration, operating under a deed of company arrangement, under restructuring or subject to a restructuring plan, transactions held to be an unfair preference or uncommercial will only be voidable where the transaction was also an 'insolvent transaction'; that is, an unfair preference or uncommercial transaction that occurred while the company was cash-flow insolvent, or contributed to the company becoming cash-flow insolvent.

Each type of voidable transaction has different criteria and must have occurred during certain time periods prior to administration or liquidation. The relevant time periods are generally longer if the transaction involves a related party. For example, there are longer time periods for insolvent transactions involving a related party or entered into to defeat, delay or interfere with the rights of any or all creditors in a winding up may be voidable.

An unfair preference arises in circumstances where an unsecured creditor receives an amount greater than would have been received if the creditor had been required to prove for it in the winding-up of the relevant company, whereas transactions have been held to be uncommercial where an objective bystander in the company's circumstances would not have entered into it.

In addition, the court has the power to determine a loan to be unfair (and, therefore, voidable) if the terms of the loan (specifically the interest and charges) could not be considered to be commercially reasonable (i.e., they are extortionate). In practice, this provision has been seldom used, and the courts in Australia are reluctant to intervene unless the commercial terms greatly deviate from typical market terms (taking into account the financial situation of the company).

A creditor-defeating disposition occurs where company property is transferred and the consideration payable at the time of the agreement (or, where there is no agreement, when the transfer occurred) was less than the market value (or the best price reasonably obtainable), with the effect of preventing, hindering or significantly delaying property becoming available for the benefit of creditors in the winding-up of the company.

Upon the finding of a voidable transaction, a court may make a number of orders, including orders directing a person to transfer the property that was the subject of the impugned transaction back to the company in liquidation and orders directing a person to pay to the company in liquidation an amount that fairly represents the benefit received under the impugned transaction.

iv Ipso facto stay provisions

With effect from 1 July 2018, provisions were inserted into the Corporations Act giving effect to an automatic stay on the enforcement of *ipso facto* clauses[2] in certain contracts entered into on or after that date.

The automatic stay will apply where one of the following insolvency events occurs in relation to a company:

a voluntary administration;

b a receiver or controller is appointed over the whole or substantially the whole of the company's assets;

c the company announces, applies for or becomes subject to a scheme of arrangement to avoid a winding up;

d the appointment of a liquidator immediately following an administration or a scheme of arrangement; or

e the company is undergoing restructuring pursuant to the regime for companies with liabilities of less than A$1 million.

The automatic stay will not apply retrospectively (i.e., for agreements entered into prior to the new provisions coming into force). Relevantly, the automatic stay does not apply to other types of contractual defaults – for example, if the company has failed to meet its payment or other performance obligations under the relevant agreement.

The length of the automatic stay depends on which formal insolvency process applies to the company as follows (subject to a court order extending the stay):

a scheme of arrangement: the stay will end within three months of the announcement, or where an application is made within that three months, when the application is withdrawn or dismissed by the court or when the scheme ends or the company is wound up;

b receivership or managing controllership: the stay will end when the receiver's or managing controller's control ends;

c voluntary administration: the stay will end on the later of when the administration ends or the company is wound up; and

d restructuring: the stay will end on the later of when the restructuring ends or the company is wound up.[3]

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2 An *ipso facto* clause is a contractual clause that allows one party to enforce a contractual right, or terminate a contract, upon the occurrence of a particular event; usually upon insolvency or a formal insolvency appointment (for example, the appointment of a voluntary administrator).

3 See Sections 415D(2)–(3), 434J(2)–(3), 451E(2)–(3) and 454N(2)-(3) of the Corporations Act 2001 (Cth).

Importantly, the automatic stay does not apply once, or if, a company executes a deed of company arrangement (DOCA). The automatic stay ends when the 'administration ends', that is when a DOCA is executed by the company and the deed administrator. Accordingly, if a company does execute a DOCA and needs the protection of the automatic stay, then subject to limited exceptions, it will need to obtain court orders.

The scope of the automatic stay, specifically what contract types, rights and self-executing provisions are excluded by the automatic stay are set out in the legislation.[4] Relevantly, syndicated loans (and derivatives) are excluded from the operation of the automatic stay, and rights under those contracts will remain available to the parties should a trigger event occur. Accordingly, the impact of these changes on acquisition financings (which contemplate a customary security package) is likely to be minimal.

By contract, bilateral facility agreements are not excluded under the relevant legislation and as such the automatic stay provisions will apply to agreements entered into after 1 July 2018. The Asia Pacific Loan Market Association has issued a recommended rider clause for lenders to include in bilateral facility agreements to assist a lender in accelerating the loan as against a guarantor of that facility where the borrower is subject to a relevant insolvency process. It is important to note that this right to accelerate the loan as against the guarantor will not operate where the guarantor itself is also the subject of a relevant insolvency process under the Corporations Act.

In addition, the automatic stay does not prevent secured creditors from appointing a receiver during the decision period pursuant to Section 441A of the Corporations Act (if they have security over the whole or substantially the whole of the company's property) or enforcing security interests over perishable goods or prevent secured creditors or receivers from continuing enforcement action that commenced before the administration.

As the automatic stay provisions only came into operation from 1 July 2018 (and the provisions only apply to certain contracts entered into after that date), there has not yet been any judicial consideration of these provisions.

4 These are contained in the Corporations (Stay on Enforcing Certain Rights) Regulations 2018 (the Regulations) and the Corporations (Stay on Enforcing Certain Rights) Declaration 2018 (the Declaration). The Regulations prescribe 42 types of contracts, agreements or arrangements that are excluded from the operation of the automatic stay, and rights in those kinds of arrangements remain available to the parties to those arrangements should a trigger event occur. Among the agreement types listed under the Regulations are, but are not limited to: (1) contracts, agreements or arrangements that are a licence or permit issued by federal, state or local government; (2) contracts, agreements or arrangements that are or are directly connected with derivatives and securities financing transactions; (3) contracts, agreements or arrangements for the underwriting of an issue or sale of, or under which a party is or may be liable to subscribe for securities, financial products, bonds, promissory notes or syndicated loans; and (4) contracts, agreement or arrangements that are or govern securities, financial products, bonds, promissory notes or syndicated loans. The Declaration declares 11 kinds of rights (including self-executing clauses that, when executed, provide those rights) as excluded from the operation of the automatic stay, and those rights remain available to the parties should a trigger event occur. By way of illustration only, the kinds of rights excluded by the Declaration include, but are not limited to a right: (1) to terminate under a standstill or forbearance arrangement; (2) to change the priority in which amounts are to be paid under a contract, agreement or arrangement; and (3) of set off, combination of accounts or to net balances or other amounts.

IV PRIORITY OF CLAIMS

i Priority of claims on insolvency

Generally, unsecured claims in Australia will rank equally on a *pari passu* basis. Section 555 of the Corporations Act provides that, unless the Corporations Act provides otherwise, all debts and claims in a winding-up rank equally, and if the property of the company is insufficient to meet them in full, these claims will be paid proportionately.

There are a number of exceptions to this general proposition (see Section 556 of the Corporations Act), including: (1) expenses properly incurred by a liquidator or administrator in preserving or realising property of the company, or in carrying on the company's business (as well as other costs and amounts owed to them); and (2) employee entitlements.

Sitting outside this regime are secured creditors, who will have priority over unsecured creditors. The security granted in their favour will entitle them to priority for payment of amounts outstanding from the proceeds and realisations of assets subject to such security interests. There is one exception to this, which is that employee entitlements have a statutory priority to the proceeds of assets subject to a circulating security interest (formerly, a floating charge) on realisation by a receiver or liquidator to the extent that the property of the company is insufficient to meet these amounts.

ii Subordination and the enforceability of intercreditor arrangements

Contractual subordination is a well-accepted tenet of secured lending in Australia; accordingly, intercreditor arrangements are commonly used in Australia to contractually clarify the relationship between two or more classes of creditor (including shareholder lenders and hedging counterparties).

Structural subordination is, however, less common (with a notable exception for holdco payment-in-kind instruments, which have been gaining popularity in recent times). Accordingly, second-lien structures are able to be accommodated relatively easily from a local perspective, where contractual subordination is typically documented via an offshore law-governed intercreditor arrangement.

Unlike that contained in the Loan Market Association suite of documents, there is currently no market standard intercreditor in Australia. A set of intercreditor principles (primarily applicable to leveraged transactions) has been circulated within the market, although they have not been universally adopted. Accordingly, a number of the provisions that these principles attempted to standardise (e.g., drag rights, standstill periods, mezzanine information rights and release provisions) remain hotly contested.

V JURISDICTION

i Consent to jurisdiction

Australian courts will generally respect the submission of an Australian entity to the courts of another jurisdiction, provided the choice of jurisdiction was not entirely unconnected with the commercial realities of the proposed transaction (and that there are no public policy reasons to deny such a submission).

ii Enforceability of foreign judgments

In Australia, the enforcement of civil judgments obtained in foreign courts is generally covered by two regimes. The first is under the Foreign Judgments Act 1991 (Cth) (FJA), which applies to certain specified courts in prescribed jurisdictions. Where the relevant court is not prescribed by the FJA, the enforceability of the relevant judgment will be dealt with by common law principles.

The FJA provides a framework, based on registration, for civil judgments made in prescribed foreign courts to be enforceable in Australia. This regime applies to judgments made by certain courts in prescribed jurisdictions, for example, certain Swiss, French, Italian, German and UK courts. Under the FJA, a judgment creditor of a relevant foreign judgment may apply to an Australian court for that judgment to be registered any time within six years of the last judgment in the foreign court. The judgment may be registered if it is final and conclusive for a fixed sum of money (not being in respect of taxes, a fine or other penalty), and is enforceable by execution in the relevant foreign country. Registration gives the judgment the same force and effect as if the judgment originally had been given in the Australian registering court (subject to certain exceptions). Special rules are also applicable to the enforceability of New Zealand judgments. The registration may be set aside if the foreign court did not have the necessary jurisdiction over the judgment debtor, either because the judgment debtor did not reside or carry on business in the jurisdiction when the proceedings were brought or did not otherwise submit to the jurisdiction of the court.

However, in certain jurisdictions (such as the United States) where Australia does not have the benefit of a treaty that provides for the reciprocal recognition and enforcement of judgments in civil matters, there is no statutory recognition or statutory enforcement in Australia of any judgment obtained in a court in such a jurisdiction. Instead, a judgment made by a court of the relevant jurisdiction can only be enforced in Australia under the common law regime.

Under that regime, any final, conclusive and unsatisfied judgment of the relevant court that has the necessary jurisdiction over the judgment debtor that is in personam (that is, it imposes a personal obligation on the defendant) and is for a definite sum of money (not being a sum in respect of taxes or other charges of a like nature or in respect of a fine or other penalty) will be enforceable by the judgment creditor against the judgment debtor by action in the Australian courts (without re-examination of the merits of the issues determined by the proceedings in the relevant court). There are some exceptions, including where the proceedings involved a denial of the principles of natural justice, or the judgment was obtained by fraud or some other vitiating factor.

In seeking to enforce a foreign judgment under either regime, a practical difficulty often encountered if the foreign proceeding was not defended is proving that the foreign court has the necessary jurisdiction over the judgment debtor. Where the debtor is a corporation, the applicant will need to show that the debtor carried on business within the jurisdiction of the foreign court, either by maintaining a branch office or by employing an agent with the authority to bind the company and to conduct business there on its behalf.

In respect of recognition of foreign insolvency judgments, Australia has enacted the UNCITRAL Model Law on Cross-Border Insolvency in the Cross-Border Insolvency Act 2008 (Cth). Australian courts recognise the jurisdiction of the relevant foreign court in which the 'centre of main interest' is located and generally cooperate with foreign courts and insolvency practitioners.

VI ACQUISITIONS OF PUBLIC COMPANIES

The Corporations Act limits the manner in which a person can acquire voting securities in a listed Australian company or managed investment scheme, or an unlisted Australian company or managed investment scheme with more than 50 members, where this would cause that person's (or someone else's) voting power in the relevant entity to increase above 20 per cent or to increase (by any amount) from a starting point between 20 per cent and 90 per cent. There are two principal methods of acquiring control of an Australian publicly listed company or managed investment scheme: takeover bids or schemes of arrangement.[5]

While there is no strict legal requirement for 'certain funds' financing, from a practical perspective, and owing to the increasing sophistication of both borrowers and lenders, financiers' commitments to fund are often provided on this basis (and indeed, this is desirable from an acquirer's perspective).

i Takeover bids

Chapter 6 of the Corporations Act provides the framework for takeover bids under Australian law. A takeover bid can be made on-market or off-market, and does not require the support of the target (i.e., a bid can be made on a hostile or friendly basis). For both on-market and off-market bids, a bidder must prepare and send to the target security holders a document (known as a bidder's statement) that includes details of the offer, information about the bidder and certain other prescribed information (e.g., in relation to the bidder's intentions). The target must respond by preparing and issuing a target's statement including the target board's recommendation as to whether security holders should accept the offer, as well as any other material information.

An on-market bid is made through a broker and can only be used to acquire securities in a listed entity. On-market bids are far less common than off-market bids because they require the consideration to be 100 per cent cash and, importantly, cannot be subject to any conditions. Accordingly, it will often be the case that an on-market bid is not a viable option, for example, because the bidder requires regulatory approvals or other conditionality, or because the bidder's financing arrangements require security to be taken over the target's assets (which can only be assured in a 100 per cent ownership scenario).

An off-market bid essentially takes the form of a written offer to security holders to purchase all or a specified proportion of their securities. The consideration can take the form of cash, securities or a combination of the two. The offer must be open for acceptance for a period of not less than one month and not more than 12 months. All offers made under an off-market bid must be the same.

An off-market bid may be subject to any conditions the bidder chooses, other than conditions that are solely within the control of the bidder (or turn on the bidder's state of mind) and certain other prohibited conditions.

5 The authors also note that pursuant to Section 444GA of the Corporations Act, a deed administrator may transfer shares in a company that is subject to a DOCA, with leave of the court. Such leave will only be granted if the court is satisfied that the transfer would not unfairly prejudice the interests of members of the company. Section 444GA operates in parallel to all other prohibitions set out in the Corporations Act, such that if the acquisition of shares in the company that is subject to a DOCA will result in a person or their associate acquiring more than a 20 per cent interest in the company, an exemption granted by the Australian Securities and Investments Commission must be sought.

Typical conditions include those relating to the non-occurrence of certain statutorily prescribed events (including certain insolvency type events), the non-occurrence of a material adverse effect, the obtaining of any necessary regulatory approvals, the absence of any legal restraints or prohibitions to the acquisition completing, and the receipt of a minimum number of acceptances (usually 50 or 90 per cent, the latter corresponding to the threshold for the compulsory acquisition (or 'squeeze-out') of minorities).

Unlike the position in the United Kingdom, there is no legal requirement in Australia for 'certain funds' financing. However, the Corporations Act does prohibit persons from making an offer if they are unable, or are reckless as to whether they are able, to complete the offer. The Australian Takeovers Panel has separately indicated that it expects that where the bid is debt-funded, a bidder would have binding commitments from its lenders at the time of announcing its offer and would not declare its bid unconditional unless it is highly confident that it can draw down on these facilities (i.e., binding funding arrangements are documented in final form and commercially significant conditions precedent to draw down have been satisfied or there is no material risk such conditions precedent will not be satisfied).[6]

ii Schemes of arrangement

A scheme of arrangement is a court-approved arrangement entered into between a body (i.e., the target) and all, or a class, of its members. For a scheme to become binding on the target and its members (or the relevant class thereof), it must be approved by more than 50 per cent of members who vote on the scheme and those members must represent at least 75 per cent of the votes cast on the scheme. If these thresholds are met, the scheme is binding on all members (or all members in the relevant class), including those who vote against the scheme or do not vote at all. The test for identifying classes for the purposes of a scheme is that a class should include those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to a 'common interest'. However, the decision in *In the matter of Boart Longyear Limited (No. 2)* suggests that courts may be willing to stretch the boundaries of what would ordinarily be considered to be the composition of a class and, in doing so, may agree to put persons in the same class even where such persons appear to have objectively distinct interests.[7]

The typical operation of a scheme in the context of a control transaction is for the scheme to effect the transfer of target securities to the offeror in exchange for a specified consideration.

A scheme of arrangement is essentially a target-driven process, with the target preparing the necessary security holder materials and seeking the necessary orders from the court. As such, a scheme requires the support of the target's directors and therefore is only a viable option in 'friendly' transactions.

There is no statutory requirement for 'certain funds'; however, as part of the court process, the offeror will be required to satisfy the court that it has sufficient funds to pay the scheme consideration and consummate the transaction. On a practical level, and in addition to giving the target's board comfort as to their ability to execute the transaction, this often results in offerors seeking certain funds funding from their financiers.

The consideration under a scheme can be structured such that security holders receive cash, securities or a combination of the two. There is more flexibility under a scheme with

6 Australian Takeovers Panel 'Guidance Note 14 – Funding arrangements'.

7 See *In the matter of Boart Longyear Limited (No. 2)* [2017] NSWSC 1105 and *First Pacific Advisors LLC v. Boart Longyear Ltd* [2017] NSWCA 116.

respect to the structure of the consideration as, unlike in a takeover bid, it is not necessary for all offers under a scheme to be the same, more easily facilitating differential treatment of security holders. Schemes can also be used to implement corporate restructures, demergers and debt-for-equity transactions. Specific to creditors' schemes of arrangement, on 3 May 2021, the federal government announced that it would consult industry on improving creditors' schemes of arrangement to better support businesses, including by introducing a moratorium on creditor enforcement while schemes are being negotiated. The consultation aimed to assess whether the current creditor scheme of arrangement process is useful as a means of restructuring insolvent companies. In its current form, the schemes of arrangement are typically used in relation to complex restructurings of large corporate groups, involve a high level of court involvement and, unlike other insolvency processes (such as voluntary administration), there is no automatic moratorium to prevent creditors from bringing claims against the company during the negotiation and formation of the scheme. The consultation also sought input on the efficacy of the current scheme of arrangement framework generally. Submissions were due by 10 September 2021.

As with off-market bids, schemes can be subject to conditions, and it is common to see schemes being subject to the receipt of any necessary regulatory approvals, together with the non-occurrence of any material adverse effect with regards to the target. In addition, there are standard conditions relating to the necessary shareholder and court approvals.

VII THE YEAR IN REVIEW

The value of Australian syndicated lending increased by 29.75 per cent over the first half of 2022 (year on year) relative to the same period in 2021 (US$56.7 billion in the first half of 2022, up from US$43.7 billion in the first half of 2021).[8] The increase was driven by merger and acquisition activity, which contributed 40 per cent of the volume of Australian transactions.[9]

Australian merger and acquisition activity made up the predominant share of the activity in the Asia-Pacific region, making up more than 62 per cent of the total volume in the region during the first half of 2022.[10] Factors contributing to the strong Australian M&A activity in the first half of 2022 include a low interest rate environment and market confidence in Australia as a favourable jurisdiction for international dealmakers seeking opportunities in the Asia-Pacific region. Some notable transactions include Sydney Aviation Alliance's A$32 billion acquisition of Sydney Airport (the largest public M&A transaction in Australia's history), Square Inc's A$20.3 billion acquisition of Afterpay (although initially valued at A$39 billion in August 2021, this was completed with the lower amount of A$20.3 billion in February 2022; the largest cross-border fintech deal globally to date), Blackstone's A$8.9 billion acquisition of Crown Resorts, KKR's A$5.1 billion acquisition of Spark Infrastructure Group and TPG Capital's A$4 billion sale of Greencross.

Despite a buoyant start to 2022, strong economic headwinds in the form of inflation and increased cost of funding together with geopolitical challenges and market uncertainty led to reduced levels of M&A-related activity, and lower syndicated loan market activity, in the third quarter of 2022. The value of Australian syndicated lending decreased by 3 per cent

8 Source: Refinitiv, '1H 2022 REVIEW: Asia Pacific syndicated loan volume reaches US$267 billion'.
9 Source: Refinitiv, '1H 2022 REVIEW: Asia Pacific syndicated loan volume reaches US$267 billion'.
10 Source: Refinitiv, '1H 2022 REVIEW: Asia Pacific syndicated loan volume reaches US$267 billion'.

and the number of syndicated loans decreased by 27 per cent, in each case, over the first nine months of 2022 (year on year) relative to the same period in 2021 (US$78.1 billion in the first nine months of 2022, down from US$80.5 billion in the first nine months of 2021).[11]

In the first half of 2022, the Australian unitranche market remained somewhat less attractive as compared with term loan B (TLB) financing, with TLB financing constituting a larger market share for leveraged buyout deals (LBOs) in Australia and New Zealand. Of the total US$5.69 billion loans that funded LBOs completed in the first quarter of 2022 in Australia and New Zealand, traditional bank loans accounted for 51 per cent, TLBs accounted for 40.4 per cent, and unitranche deals the remaining 8.6 per cent.[12] However, with the US TLB financing market being increasingly affected by macroeconomic conditions, the Australian unitranche market has grown to be a more appealing option, with a number of notable LBOs completed in Australia in the second half of 2022 funded by unitranche facilities (for example, TPG Capital's A$2 billion acquisition of a controlling stake in iNova Pharmaceuticals). Traditional bank loans are also being considered more frequently as a viable option by sponsors who have historically looked to raise debt in the unitranche and TLB financing markets, due to the banks offering competitive pricing and a willingness by some sponsors to forgo flexibility for economics in the current environment.

Following a string of substantial government privatisations in past periods, which included the privatisation of a majority stake in the WestConnex freeway project (A$9.26 billion), the New South Wales Land Registry Services (A$2.6 billion) and the Victorian Land Titles and Registry office (A$2.86 billion), 2022 has continued the trend from previous years and seen a continued deceleration in the number of privatisations and new infrastructure projects with some of the more notable transactions involving the refinancing of existing debt. Despite the slowdown, asset privatisation remains an integral part of broader government strategy as it allows governments to unlock significant capacity to reinvest into new transport and social infrastructure projects, which in turn generates additional deal flow.

Notable projects and project financing transactions in 2022 include APN Property's acquisition by DEXUS Property Group (covering more than A$3 billion of real estate assets), ESR Milestone Partnership's (a partnership between ESR and Singapore's sovereign wealth fund GIC) acquisition of the Milestone Logistics Portfolio (A$2.23 billion) and HKMA's acquisition of Brookfield Place Sydney (A$1.8 billion).

VIII OUTLOOK

ESG considerations are expected to become an even more common feature in M&A activity as various stakeholders demand that companies operate in a sustainable way. These stakeholder demands have materialised in multiple ways, including, for instance, incoming ESG-focused investors and investment funds seeking out suitable investments for their capital, and this is also true for the debt finance market where financiers are prepared to offer financing with better pricing to borrowers that agree to ESG-related covenants. In juxtaposition to these sustainable outcomes, it is also expected that ESG considerations will drive M&A activity where incumbent shareholders apply pressure on companies to divest dirty assets that would

11 Source: Refinitiv, 'Global Syndicated Loans Review First Nine Months 2022'.

12 Source: Debtwire Par – 'Debtwire Par – DebtDynamics APAC (ex-Japan): Australia/NZ unitranche volumes surge on USD 1bn-plus Greencross deal; TLBs, loans for PE-linked M&As active in 1Q22' Jason Huang Jones, 13 April 2022.

have otherwise been tightly held, but have now become available on the market. For instance, Grok Ventures' recent influence applied to AGL to require AGL to act in an environmentally sound ways (including to bring forward the closure of certain coal-fired powerplants).

Aside from investor-focused ESG concerns and ESG-related shareholder activism, there has also been increased regulatory focus on greenwashing in European jurisdictions, and while there is currently no specific regime in Australia, the local regulator (the Australian Securities and Investments Commission) is actively monitoring the market for potential greenwashing and has demonstrated, by taking its first formal enforcement action for greenwashing in October 2022 and issuing penalties to an Australian listed company on the basis that it made representations that were factually incorrect, that it is willing to implement regulatory rigour to enhance governance and accountability.

We anticipate that strong economic headwinds will continue to shape the next 12 months. Global political challenges, economic uncertainty, inflation and increased cost of funding (including increases in the cash rates, margins and establishment fees) are all factors that will continue to dampen M&A-related activity. As such, M&A-related activity will be driven by a search for stability. Market sentiment towards Australia remains optimistic as dealmakers recognise that, notwithstanding the current global uncertainty, Australia has attractive features (including legal certainty, political stability, a relative low risk compared with regional markets and dynamic industries) that remain intact and available to support deal flow.

Appendix 1

ABOUT THE AUTHORS

JOHN SCHEMBRI

Gilbert + Tobin

John Schembri is the head of Gilbert + Tobin's banking and projects group. His major area of practice is leveraged and acquisition finance, together with structured and project financing. He also has significant experience in various other areas, including the financing of construction and resources projects, property, acquisition and general corporate financing.

Mr Schembri's experience also extends to corporate debt and leveraged finance transactions, including the financing of specific asset acquisitions as well as funding general working capital requirements. In this area, he has acted for both lenders and borrowers and in secured, unsecured, syndicated and club loan arrangements.

He is recognised as a leading banking and project finance lawyer in numerous publications, including leading directories such as *Chambers*, *The Legal 500*, *Best Lawyers* and *IFLR1000*.

Mr Schembri holds a bachelor of arts degree, a bachelor of laws degree with first-class honours and a master of taxation degree from the University of Sydney. He is admitted as a solicitor of the Supreme Court of New South Wales and the High Court of Australia, and has also been admitted to the Roll of Solicitors in England and Wales and as a solicitor of the Supreme Court of England and Wales.

ERIN CARTLEDGE

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Erin Cartledge is a senior lawyer in Gilbert + Tobin's banking and projects group. Her practice is primarily focused on leveraged and acquisition finance transactions, both local and international. In this area, Erin has advised lenders, borrowers and sponsors across a number of transactions including secured, unsecured, syndicated and club loan arrangements (and including TLB and unitranche transactions). Ms Cartledge's experience also extends to general corporate finance transactions and distressed debt transactions.

In addition to her time at Gilbert + Tobin, she has also worked for a number of years in the New York office of a large international firm.

Ms Cartledge holds a bachelor of economic and social sciences degree and a bachelor of laws degree with first class honours from the University of Sydney. She is admitted as a solicitor of the Supreme Court of New South Wales and the High Court of Australia, and has also been admitted as an attorney of the New York State Bar.

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