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Dispute Resolution

Legal Update

Ipsa Facto Provisions Commenced on 1 July 2018: Are You Ready to Advise Affected Clients?

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Ipso Facto Provisions Commenced on 1 July 2018: Are You Ready to Advise Affected Clients?

by Practical Law Dispute Resolution

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Speedread

From 1 July 2018, new provisions introduced into the *Corporations Act 2001* (Cth) (CA 2001) by the *Treasury Laws Amendment (2017 Enterprise Incentives No 2) Act 2017* (Cth) (Amending Act), impose a stay on the enforcement of ipso facto clauses against a company that becomes subject to certain prescribed insolvency events.

The new provisions (*sections 415D-415G, 434J-434M and 451E-451H, CA 2001*) apply to contracts entered into after 1 July 2018. Ipso facto clauses in contracts entered into before the commencement date are still enforceable, even if novated, varied or assigned after that date. Self-executing provisions that provide for automatic termination are also caught.

Certain categories of contracts and contractual rights are excluded from the stay pursuant to:

- *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018* (Cth) (registered on the Federal Register of Legislation on 22 June 2018).
- *Corporations Amendment (Stay on Enforcing Certain Rights) Declaration 2018* (Cth) (registered on the Federal Register of Legislation on 28 June 2018).

This update provides an overview of how the stay operates, some tips and strategies that may be available for counterparties who intend to contract with a company after 1 July 2018 or have contracted with a company prior to 1 July 2018, and a list of Practical Law resources that are available to assist you in advising clients who may be affected by the new provisions, whether they are at the stage of either:

- Contracting with a company (and looking to protect their rights against the possibility that the company later becomes subject to an insolvency event).
- Seeking to terminate or enforce other contractual rights against a company in financial difficulty or external administration.

Background

An ipso facto clause is a provision in a contract which allows one party to terminate or enforce other rights in relation to it if a counterparty experiences an insolvency event.

From 1 July 2018, new sections 415D to 415G, 434J to 434M and 451E to 451H of the *Corporations Act 2001* (Cth) (CA 2001) (introduced by the *Treasury Laws Amendment (2017 Enterprise Incentives No 2) Act 2017* (Cth)) impose a stay on the enforcement of ipso facto clauses against a company that becomes subject to a substantial **receivership**, **voluntary administration** or **scheme of arrangement** (see *Stay on the enforcement of ipso facto clauses*).

The reforms are intended to address the situation where significant company contracts are automatically terminated on the company becoming subject to an insolvency event, which can often further diminish the value of the company's business and reduce the scope for a successful restructure or sale of the business as a going concern. The reforms aim to increase the potential for the business to recover from the relevant insolvency event and continue to trade.

Stay on the enforcement of ipso facto clauses

Pursuant to the new stay provisions, a party cannot enforce a contractual right (including the right to terminate a contract) against a company if:

- The contract was entered into after 1 July 2018.
- The reason for enforcing the right is:
 - the appointment or existence of a managing controller (including a receiver and manager) over the whole or substantially the whole of the company's property (or the company's financial position, if the substantial receivership appointment has already been made);
 - that the company has come or is under administration (or the company's financial position, if the company is under administration);
 - that the company has publicly announced its intention to apply for approval to enter a scheme of arrangement to avoid being wound up in insolvency, or is the subject of such an application or scheme (or the company's financial position, if the company is the subject of such an announcement, application or scheme); or
 - a reason prescribed by regulations or a reason that is, in substance, contrary to the stay provisions.
- The right arises under an express provision of the contract.

(Sections 415D-415G, 434J-434M and 451E-451H, CA 2001.)

Broadly, the stay applies for the duration of the relevant external administration and may remain in place indefinitely after the end of that period, to the extent that a reason for a party later seeking to enforce a right is:

- The company's financial position before the end of the stay period.
- The company having been the subject of a substantial receivership, voluntary administration or scheme of arrangement (or an announcement of intention to apply for approval of a scheme or application) before the end of the stay period.
- A reason prescribed by the regulations relating to circumstances in existence during the stay period, or a reason that, in substance, is contrary to the stay provisions.

(Sections 434J(4), 451E(4) and 415D(4), CA 2001.)

Certain contracts and contractual rights are excluded from the stay by regulations and declaration (see *Excluded contracts and contractual rights*).

A party may either apply to court or obtain the relevant external administrator's written consent to exercise a contractual right that is otherwise stayed (sections 434J(7), 434K; 451F, 451E(7), 415D(8) and 415E(1), CA 2001).

Excluded contracts and contractual rights

Certain types of contracts and contractual rights are excluded from the operation of the stay under:

- New regulation 5.3A.50(2) of the *Corporations Regulations 2001* (Cth) (introduced by the *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018* (Cth)).
- The *Corporations Amendment (Stay on Enforcing Certain Rights) Declaration 2018* (Cth) (Declaration).

The new regulation 5.3A.50(2) of the *Corporations Regulations 2001* (Cth) excludes the following types of contracts from the stay provisions (among others):

- Government licences or permits.
- Arrangements relating to securities and financial products, such as:
 - derivatives;
 - arrangements for the underwriting of an issue or sale of securities, financial products, bonds, promissory notes, or syndicated loans;
 - subscription agreements for securities, financial products, bonds, promissory notes or syndicated loans;
 - arrangements for the issue of securities or the offer of securities under a rights issue; and
 - arrangements that are or govern securities, financial products, bonds, promissory notes or syndicated loans.
- Business sale agreements and share sale agreements.
- Complex arrangements to which a special purpose vehicle is a party (where those arrangements provide for securitisation, a public-private partnership or project finance).
- Arrangements relating to debt and the ranking of creditors (such as subordination arrangements, flawed asset arrangements and factoring arrangements).
- A contract, agreement or arrangement entered into before 1 July 2018 that is novated, varied or assigned on or after 1 July 2018 but before 1 July 2023.

Section 5(4) of the Declaration excludes the following types of contractual rights from the stay provisions (among others):

- Rights entitling a lender to change the basis on which an amount is calculated (including the right to charge a higher rate of interest) under a financing arrangement, guarantee or security, triggered on an insolvency event.
- Termination rights in a standstill or forbearance arrangement.
- Rights of set-off and rights to combine accounts and net balances (and rights of acceleration exercised for the purpose of set-off, netting or combination of accounts).

- Rights of assignment and novation.
- Rights to appoint a receiver or other controller to property of a company where another receiver or controller has been appointed to that property.

For further information in relation to the exclusions, see [Legal update, Exclusions from stay of enforcement of ipso facto clauses: draft regulations and declaration released](#).

Implications and key considerations for counterparties to company contracts

The stay provisions will have broad ranging effect on many types of contracts and agreements across different industries, including:

- Leases.
- Loan agreements (for example, any general right of acceleration of debt triggered on an insolvency event will be stayed under the new provisions).
- Supply contracts.
- Construction contracts and other long-term services contracts (although step-in rights, which entitle one party to “step-in” to the shoes of the other party when the latter becomes subject to an insolvency event, and enforce certain rights or perform obligations of the second party, are excluded from the stay provisions).

However, there are a number of actions and strategies that may be available to a party to protect its rights and interests, whether they are seeking to:

- Contract with a company.
- Terminate, enforce or otherwise protect its rights and interests in relation to a contract with a company that is in financial difficulty or has become subject to an external administration process.

Considerations when contracting with a company

A party seeking to contract with a company might consider taking the following actions to ensure that its rights and interests are protected as far as possible if the company later becomes subject to an external administration process:

- Extend any existing contracts or agreements entered into before 1 July 2018, and make sure to do so before 1 July 2023 (the stay provisions do not affect existing termination and other rights under those contracts, even if they are novated, varied or assigned on or after 1 July 2018 but before 1 July 2023).
- Ensure that rights of termination for non-payment and any other defaults that are not caught by the stay provisions are clear and enforceable.
- Ipso facto clauses providing for termination and other rights can still be included in post-1 July 2018 contracts but could be expressed to be subject to the new stay provisions in the CA 2001. This will ensure that those rights remain available and maximise the counterparty’s ability to enforce them in certain excepted circumstances permitted by the legislation.

Actively monitoring the company’s performance and financial health during the life of the contract

A counterparty to a significant contract or agreement with a company might consider closely monitoring the company’s performance and financial health generally so that it is in a position to take early action to terminate or enforce other contractual rights before the stay provisions are triggered by the commencement of an external administration process.

This will assist to enable the counterparty to:

- Avoid being subsequently restricted from terminating or exercising other rights under the relevant contract during the external administration period (and effectively indefinitely after that, subject to some exceptions).
- Crystallise its loss under the relevant contract, and stem any further loss that might otherwise be suffered as a consequence of the contract technically remaining “on foot” during the period of external administration (and beyond).
- (Where relevant) accelerate all debt owed under the relevant agreement and maximise its ability recover against any third party guarantee, bank guarantee or other security.

Protecting and enforcing contractual rights against a company in external administration

A counterparty seeking to enforce termination or other contractual rights against a company that has become subject to an external administration might consider taking the following steps (where appropriate):

- Assess whether or not the stay provisions apply to the contract or contractual right sought to be enforced, or whether it is excluded by the legislation.
- If possible, identify a non-stayed default on which to terminate or exercise other rights in relation to the contract (for example, non-payment).
- Determine whether it is commercially desirable to terminate (if permitted by the legislation) or maintain the contract.
- If the contract is able to be terminated (or other rights exercised) without contravening the stay provisions and it is commercially desirable to take that action, the counterparty should ensure that any formal correspondence to the company is carefully drafted and specifically identifies that non-stayed default as the ground for termination.
- If it is not possible to terminate or exercise other rights under the contract due to the operation of the stay provisions, the counterparty could engage with the external administrator as soon as possible on his or her appointment to seek his or her consent to take the desired action in relation to the contract.
- Enforce against any personal guarantee or bank guarantee that the counterparty may hold to secure the company’s performance of its obligations under the contract (to the extent of the relevant non-stayed default at the time of the external administration appointment).

Further information

Practical Law is developing a suite of resources to assist you in advising clients who may be affected by the new provisions, whether they are:

- External administrators faced with a counterparty to a company contract seeking to terminate or exercise other rights in relation to it.
- Parties seeking to:
 - contract with a company (and looking to protect their rights against the possibility that the company later becomes subject to an insolvency event); or
 - enforce termination or other contractual rights against a company that is in financial difficulty or has become subject to an external administration process.

The first resources that are available in this suite are:

- [Practice note, Ipso facto clauses: Enforcing termination and other contractual rights against a company in external](#)

administration.

- Checklists:
 - *Tips and strategies for contracting with a company: ipso facto and other clauses*; and
 - *Tips and strategies for protecting and enforcing contractual rights against a company in external administration.*
- *Toolkit, ipso facto clauses.*

For further information in relation to the effect of the different types of external administration on a company and its key stakeholders, see Checklists:

- *Quick guide to the effect of receivership on the company and key stakeholders.*
- *Quick guide to the effect of voluntary administration on the company and key stakeholders.*
- *Quick guide to the effect of liquidation on the company and key stakeholders.*
- *Quick guide for landlords: external administration of a corporate tenant.*

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