

AUSTRALIA'S NEW IPSO FACTO REGIME IS NOW LIVE: ARE YOUR CONTRACTUAL RIGHTS AFFECTED?

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Legal Briefings - By **Paul Apáthy, Patrick Lowden, Andrew Rich, Rowena White, James Kirkpatrick and Daniel Stathis**

Australia's new *ipso facto* regime is now in effect. It stays the enforcement of contractual rights triggered upon the entry of a corporate counterparty into certain restructuring and insolvency processes. The regime will affect a broad range of contracts entered into on or after 1 July 2018; however, certain contracts and contractual rights have been excluded from the operation of the stay pursuant to statutory instruments which have just been issued. Critically, in respect of financing arrangements, the *ipso facto* reforms will not apply to (among other things) syndicated loans, securities, bonds, promissory notes, financial products, derivatives, and certain contracts involving special purpose vehicles. Other contracts and rights will need to be reviewed carefully to assess the impact of the new regime.

IN BRIEF

- The new *ipso facto* regime came into effect on 1 July 2018. Unless excluded, the stay provisions will apply to all contracts, agreements or arrangements entered into on or after that date. The scope of the regime is extremely broad.

- The *ipso facto* stay restricts the ability of contractual counterparties to exercise termination, enforcement or other contractual rights under affected contracts that are triggered by the entry of a company into or commencing a specified insolvency or restructuring procedure.
- Certain types of contracts and rights are exempted from the operation of the *ipso facto* stay, as set out in the recently issued [Corporations Amendment \(Stay on Enforcing Certain Rights\) Regulations 2018 \(Amending Regulations\)](#), [Corporations Amendment \(Stay on Enforcing Certain Rights\) Regulations \(No. 2\) 2018 \(Second Amending Regulations\)](#) and [Corporations Amendment \(Stay on Enforcing Certain Rights\) Declaration 2018 \(Declaration\)](#).
- A number of key changes have been made to the exceptions contained in the Amending Regulations, Second Amending Regulations and Declaration (together, the **Instruments**) since exposure drafts were put to public consultation in April 2018.
- Key changes in the final Instruments include:
 - syndicated loans, bonds and promissory notes are now exempt;
 - the ‘grandfathering’ exception with respect to novations, assignments or variations of contracts entered into before 1 July 2018 will only apply until 2023;
 - the exclusion for special purpose vehicle (**SPV**) contracts has been limited to securitisations, public-private partnerships and certain project finance arrangements;
 - the exceptions for the appointment of receivers (and other controllers) have been expanded to allow such appointments by ‘all-asset’ secured creditors following the proposal of a scheme of arrangement;
 - ‘rights to take action’ are now permitted for the purposes of enforcing set-off, netting and account combination rights, and for the purposes of the appointment of receivers (and other controllers) in certain circumstances;
 - high-value construction contracts have been excluded until 2023;
 - public hospital and health exceptions have been introduced;
 - certain government contracts have been excluded;

- certain outsourcing contracts (that are subject to *Prudential Standard CPS 231* or *Prudential Standard SPS 231*) have been excluded; and
- the exception for step-in rights has been clarified.
- The *ipso facto* reforms will affect contracts in all industries and segments of the market. We encourage businesses of all types to familiarise themselves with the new *ipso facto* regime, review their contracts to consider the regime's impact on them and make amendments where appropriate.

THE NEW *IPSO FACTO* REGIME

The new *ipso facto* regime was enacted by way of the [Treasury Laws Amendment \(2017 Enterprise Incentives No. 2\) Act 2017](#) (the **Amending Act**) in September 2017.

Part 2 of the Amending Act has amended the [Corporations Act 2001 \(Cth\)](#) (**Corporations Act**), as of 1 July 2018, by inserting a number of specific sections that provide for the operation of the *ipso facto* stay in the context of certain corporate restructuring and insolvency procedures.

WHAT ARE *IPSO FACTO* CLAUSES?

An *ipso facto* clause is a contractual provision that allows one party to terminate or modify the operation of the contract (or provides for this to occur automatically) upon the occurrence of a specified insolvency related event.

For example, a clause in a lease that entitles one party to terminate the lease if an administrator is appointed to the other party is an *ipso facto* clause. Similarly, an event of default under a loan agreement caused by a receiver being appointed to all of the borrower's assets is also an *ipso facto* clause. These types of clauses are very common in commercial contracts.

WHAT IS THE PURPOSE OF THE *IPSO FACTO* REGIME?

By limiting an insolvent company's counterparties' ability to terminate contracts or exercise other rights solely on the basis of the company's entry into a specified restructuring or insolvency procedure, or on the basis of its financial condition during that procedure, the new regime seeks to enhance the likelihood that a company will be able to continue to trade in order to recover from an insolvency event.

THE STAY ON *IPSO FACTO* CLAUSES

The new regime provides that during the period of a specified restructuring or insolvency procedure, a right in a contract, agreement or arrangement will not be enforceable, and 'self-executing provisions' will not apply, by reason only of:

- the company entering the specified procedure;
- the company's financial position;
- a prescribed reason; or
- a reason that is in substance contrary to the above.

However, according to the Explanatory Memorandum to the Amending Act, the stay is not intended to restrict a counterparty from enforcing a right (or disapply self-executing provisions) for any other reason, such as a breach involving non-payment or non-performance.

In addition, the *ipso facto* provisions also allow the relevant insolvency administrator to apply for an order expanding the stay to prohibit the exercise of rights (for example, a right to terminate for convenience), even where the right does not expressly operate on the basis of one of the prohibited reasons set out above, if the court is satisfied that a counterparty is likely to exercise those rights for a prohibited reason.

WHAT PROCEDURES DOES THE *IPSO FACTO* STAY APPLY TO?

The *ipso facto* regime applies in respect of any of the following procedures:

- administration;
- managing controller appointments (including receiverships) over the whole or substantially the whole of a company's property; and
- schemes of arrangement (proposed for the purpose of avoiding an insolvent winding up).

However, the legislation does not (explicitly) apply to:

- receiver or other controller appointments that are not over the whole or substantially the whole of a company's property;
- deeds of company arrangement; or

- liquidations that do not immediately follow an administration or scheme of arrangement.

NEW ADVANCES OF MONEY OR CREDIT

Critically, where a counterparty is restricted by the stay from exercising *ipso facto* rights against a company, there is a corresponding stay on the right of the company to require a new advance of money or credit from that counterparty.

This is intended to protect lenders and other counterparties from being required to advance further funds to a company that has entered into a formal insolvency or restructuring procedure (in circumstances where the counterparty is prohibited from exercising contractual rights due to the *ipso facto* stay).

However, a 'new advance of money or credit' is not defined and therefore the scope of this corresponding stay is not clear. For example, would an obligation to supply goods or services on credit or the extension of a rollover loan be considered a 'new advance of money or credit'?

WHAT CONTRACTS DOES THE *IPSO FACTO* STAY APPLY TO?

The regime applies to all contracts, agreements or arrangements entered into on and from 1 July 2018, in the circumstances outlined above (and subject to the exceptions outlined below).

The regime is not, on its face, restricted to contracts governed by Australian law (although principles of statutory construction and private international law may limit the effect of the regime on foreign law contracts).

EXCEPTIONS TO THE *IPSO FACTO* STAY

The Amending Act is supplemented by the Instruments that prescribe types of contracts and rights that are excluded from the operation of the stay. Given the breadth of the statutory regime, the exceptions provided for in the Instruments are critical for delineating the scope of the *ipso facto* regime.

EXCEPTIONS TO THE *IPSO FACTO* STAY

There are two categories of exceptions:

- **excluded types of contract:** these are contained in the Regulations, which have inserted additional provisions into the *Corporations Regulations 2001* (Cth) (**Corporations Regulations**). Where a contract is excluded, all rights under that type of contract are exempt from the operation of the *ipso facto* stay; and

- **excluded types of contractual rights:** these are contained in the Declaration. The excluded rights are narrowly focused on specific kinds of contractual rights that are exempt from the *ipso facto* stay. These rights are excluded regardless of the type of contract in which they are contained.

There is uncertainty around the ambit of many of these exclusions, and a number import specific statutory definitions which may not accord with general expectations as to the meaning of the terms. Caution is therefore advised when considering their application to specific agreements and transactions.

EXCLUDED TYPES OF CONTRACT

The types of contract that are excluded from the operation of the *ipso facto* stay are set out in full in the [Corporations Regulations](#) (as amended by the [Amending Regulations](#) and the [Second Amending Regulations](#)). These can be briefly summarised as follows (although, as noted above, stakeholders should carefully consider the specific wording of the exceptions in the Corporations Regulations, and related statutory definitions):

Debt and equity capital markets

- arrangements for underwriting the issuance or sale of securities, financial products, bonds, promissory notes or syndicated loans;
- subscription agreements for securities, financial products, bonds, promissory notes or syndicated loans;
- securities, financial products, bonds, promissory notes or syndicated loans, and the agreements that govern these instruments;
- arrangements where a company issues securities, or offers securities under a rights issue;
- arrangements for issuance of securities, financial products, bonds, promissory notes or syndicated loans belonging to a pre-1 July 2018 fungible class;
- covered bonds and related agreements;

Other financing arrangements

- securities financing transactions;
- margin lending facilities and related agreements;
- factoring arrangements and related agreements;
- agreements that are subject to the Cape Town Convention on International Interests in Mobile Equipment;
- contracts under which the priority of security interests change;
- flawed asset arrangements;

Securitisation, PPP, project finance and construction

- arrangements that involve an SPV and that provide for securitisation, a public-private partnership, or certain project finance arrangements;
- certain arrangements relating to construction contracts entered into after 1 July 2018, but before 1 July 2023, where the total payments under all contracts for a project exceed A\$1 billion;

Mergers and acquisitions

- business sale agreements and share sale agreements;

Derivatives, netting, clearing and payments

- derivatives;
- certain close-out and netting arrangements;
- financial market operating rules and certain arrangements relating to payment, clearing

and settlement facilities;

- certain arrangements relating to approved RTGS systems;

Government and public sector

- government licences, permits or approvals;
- contracts relating to Australia's national security;
- contracts relating to the supply of goods or services to, from or on behalf of a public hospital or public health service;
- certain contracts related to the provision of essential or critical goods or services to, or carrying out of essential or critical works for, government;

Other

- certain arrangements for the commercial charter of international ships;
- certain outsourcing arrangements entered into by APRA-regulated institutions and RSE licensees;
- agreements for the management of financial investments;
- agreements for the keeping of source code or passwords, or related material, in escrow; and
- contracts entered into or renewed on or after 1 July 2018, but before 1 July 2023, resulting from a novation, assignment or variation of a contract entered into prior to 1 July 2018.

EXCLUDED TYPES OF CONTRACTUAL RIGHT

The types of right that are excluded from the operation of the *ipso facto* stay are set out in full in the [Declaration](#). These primarily relate to finance contracts and can be briefly summarised as follows (although, as noted above, stakeholders should carefully consider the specific wording of the exceptions in the Declaration):

- rights to change the basis on which an amount is calculated under a financing arrangement or guarantee, indemnity or security related to a financing arrangement (for example, the charging of default interest);
- rights to indemnities for charges, expenses, losses or liabilities arising from the preservation or enforcement of rights;
- termination rights in a standstill or forbearance arrangement;
- rights to change the priority or order in which amounts are paid, distributed or received;
- rights of set-off and netting, to net balances or combine accounts;
- a 'right to take action' to enforce rights of set-off, netting or to combine accounts or to appoint receivers or other controllers in certain circumstances;¹
- rights of assignment and novation;
- rights in relation to the treatment of circulating assets and chattel paper in insolvency to ensure there is no conflict between the Amending Act and the *Personal Property Securities Act 2009* (Cth);
- certain step-in rights;
- certain rights to enforce possessory security interests held by authorised-deposit taking institutions in cash, negotiable instruments, securities and derivatives;
- the right of a secured creditor to appoint a receiver or other controller to an asset, where another receiver or controller has been appointed;
- the right of an all-assets secured creditor to appoint a receiver or other controller to an asset, where a scheme to avoid an insolvent winding up has been proposed;
- enforcement rights (including acceleration rights, rights to exchange currencies or rights to crystallise a security interest) for the purpose of enforcing the right of a secured creditor to appoint a receiver or other controller to an asset, where another receiver or controller has been appointed; and
- enforcement rights (including acceleration rights, rights to exchange currencies or rights to crystallise a security interest) for the purpose of enforcing the right of an all-assets secured creditor to appoint a receiver or other controller to an asset, where a scheme to avoid an insolvent winding up has been proposed.

COMMENTS ON THE EXCEPTIONS CONTAINED IN THE FINAL INSTRUMENTS

In [our previous article](#), we made preliminary comments on the exceptions contained in the exposure drafts of the Instruments. A number of material differences between the exposure drafts and the final Instruments have been enacted. These include:

- **Securities, financial products, bonds, promissory notes and syndicated loans are now exempted in full:** Significantly, the arrangements that are, or govern, securities, financial products, bonds, promissory notes, or syndicated loans have been excluded in their entirety from the *ipso facto* regime. According to the Explanatory Statement to the Amending Regulations, these instruments have been excluded on the basis that failure to do so may prevent Australian institutions from enforcing rights based on events of default that are typical and long-accepted in financial markets, which in turn may adversely affect Australian companies seeking to access that capital.

The terms ‘bond’, ‘promissory note’ and ‘syndicated loan’ are not defined in the Corporations Regulations or Corporations Act, which may lead to questions as to their interpretation in some cases. The Explanatory Statement to the Amending Regulations provides that securities may include instruments such as debentures, and that financial products may include insurance.

These exemptions cover a broad range of finance contracts. However, it is important to note that most types of bilateral loan facilities (and non-syndicated club facilities) will be subject to the *ipso facto* regime.

- **Novation, assignment or variation of existing contracts ‘grandfathered’ for five years:** Under the Amending Act, the *ipso facto* regime only applies to contracts entered into on or after 1 July 2018. However, there has been some uncertainty as to whether a novation, assignment or variation of a pre-1 July 2018 contract that occurs after 1 July 2018 could result in the contract becoming subject to the *ipso facto* regime.

The Amending Regulations provide some clarification in this regard, specifically providing that contracts resulting from novations, assignments and variations of pre-1 July 2018 contracts are also excluded from the *ipso facto* regime, **provided that** the novations, assignments and variations are made before 1 July 2023. This differs from the position in the exposure draft Regulations, which had previously not limited the exemption to the 5 year period.

According to the Explanatory Statement to the Amending Regulations, these instruments have been excluded on the basis that this period will allow parties to continue operating with their existing business arrangements on foot as they consider how to restructure their arrangements going forward.

- **The exclusion for arrangements involving an SPV has been limited to securitisations, public-private partnerships and certain project finance arrangements:** The scope of the SPV exception has been narrowed to exclude arrangements that involve an SPV only where the arrangement provides for:

- securitisation;
- a public-private partnership (**PPP**); or
- a project finance arrangement under which a financial accommodation is to be repaid or otherwise discharged primarily from the project's cash flow and all or substantially all of the project's assets are to be held as security for the financial accommodation.

These arrangements have been excluded on the basis that they involve sophisticated counterparties who arrange a bespoke set of rules that apply in the event that a party becomes insolvent.

There remains uncertainty over the scope of the SPV related exceptions in a number of respects. For example:

- the terms 'securitisation', 'public-private partnership' and 'project finance arrangement' are not defined in the Corporations Regulations or the Corporations Act;
- to be exempted, the contract, agreement or arrangement has to "*provide for*" securitisation, PPP or a project finance arrangement – would this include all contracts relating to these types of transactions, or only some of them?;

- in the case of project finance arrangements, most loans will have fixed maturity dates upon which they are expected to be refinanced on or before maturity. It is not clear that this accords with the requirement that the financial accommodation is to be repaid or otherwise discharged primarily from the project's cash flows.

- **Exceptions relating to appointment of receivers and other controllers by secured creditors have been expanded:** The final version of the Declaration has expanded the exceptions relating to the appointment of receivers and other controllers by secured creditors.

Under the Amending Act, there is an exception from the administration *ipso facto* stay in respect of the right of an 'all-assets' secured creditor under s 441A of the Corporations Act to take enforcement action under its securities during the 13 business day 'decision period' following the appointment of administrators to a company.

The Declaration also provides an exception from each of the *ipso facto* stays to allow a secured creditor to appoint a receiver (or other controller) to the assets of a company where (another) receiver (or other controller) has already been appointed. This is presumably intended to ensure that the secured creditor is not prohibited (by the managing controller *ipso facto* stay) from appointing its own receiver where another secured party has made such an appointment.²

In addition, the final version of the Declaration also provides an exception, from the scheme of arrangement *ipso facto* stay only, for a secured creditor to appoint a receiver (or other controller) to the assets of a company where the secured creditor has a security interest in, or over, the whole, or substantially the whole, of the property of the company. The Explanatory Statement to the Declaration indicates that this new exception is intended to ensure that a company cannot frustrate the ability of an all-assets secured creditor to appoint a controller by announcing or proposing a scheme of arrangement.

- **Exceptions for "rights to take action":** The draft Declaration had previously included a right to take an action, including accelerate an amount or convert or exchange amounts into different currencies, for the purposes of enforcing a right of set-off, combination of accounts or netting.

The final Declaration has modified this provision. Unhelpfully, the provision no longer states what the “rights to take action” actually are. However, there is an accompanying note stating that the rights referred to in the paragraph include the right to crystallise a security interest (as well as the previously included right to accelerate amounts and to convert or exchange amounts into different currencies).

The “rights to take action” may be exercised where the exercise of those rights is for the purposes of enforcing:

- a right of set-off or combination of accounts, or a right to net balances or other amounts;
- the right of an ‘all-assets’ secured creditor to appoint a receiver or other controller to the assets of a company that has proposed a scheme of arrangement; or
- the right of a secured creditor to appoint a receiver or other controller to an asset, where another receiver or controller has been appointed.

Curiously, there is no corresponding exception for an ‘all-assets’ secured creditor to “take action” in connection with the appointment of a receiver or other controller during the 13 business day ‘decision period’ following the appointment of an administrator to a company. This inconsistency appears to be an oversight that will hopefully be remedied.

The extent of this exclusion remains unclear. The Explanatory Statement to the Declaration suggests a narrow interpretation may be intended, stating (in respect of set-off) that the exemption *“only allows acceleration to the extent that this is necessary to fully exercise a right of set-off protected by this declaration.”* It is therefore unclear whether this exclusion is intended to allow a secured creditor to accelerate its debt if such acceleration was not *necessary* for the secured creditor to appoint a receiver (which may not be the case where (for example) appointment is permitted simply on the basis of a subsisting event of default).

- **High-value construction contracts have been excluded until 2023:** The Amending Regulations provide that the stay will not apply to certain construction arrangements valued over A\$1 billion for a five year transitional period. This includes arrangements for the provision of building work, construction work or the provision of related goods and services.

This transitional period recognises the complex nature of large scale construction projects and is intended to provide certainty to counterparties in respect of the operation of the *ipso facto* regime, while allowing time to consider how to structure affected arrangements in the future.

- **Public hospital and health exceptions have been introduced:** The Amending Regulations now exclude arrangements for the supply of goods or services to, by, or on behalf of a public hospital or public health service.
- **Certain government contracts have been excluded:** Arrangements relating to Australia's national security, border protection or defence capability have been excluded on the basis that parties to these arrangements must have the ability to respond to urgent and unforeseen events, and these arrangements must operate without disruption.

Arrangements for the supply of essential or critical goods or services to, or the carrying out of essential or critical works for, the state and federal governments have also been excluded pursuant to the Second Amending Regulations. What constitutes 'essential or critical' goods, services or works has not been defined. However, the Explanatory Statement to the Second Amending Regulations provides as examples public transport services, public security or safety services, and works affecting essential public infrastructure and services essential to the provision of essential services including signalling services for public transport, and maintenance services and cleaning services for vehicles used in providing public transport services.

- **Certain outsourcing contracts have been excluded:** Outsourcing arrangements subject to *Prudential Standard CPS 231* or *Prudential Standard SPS 231* involving certain material business activities undertaken by APRA-regulated institutions and registrable superannuation entity licensees (**RSE**) have been excluded from the operation of the stay. This exclusion is intended to ensure that the *ipso facto* stay will not impinge on the promotion of sound governance and risk management practices by these institutions and licensees.

'Material business activities' in this context include: (1) an activity that would if disrupted have a potentially significant impact on the relevant entity's business operations, or its ability to manage risk effectively; and (2) for RSEs only: (a) the interests of beneficiaries; or (b) the financial position of the RSE or its connected entities.

- **Exception for step-in rights has been clarified:** The scope of the step-in rights exception has been expanded and clarified. This exception now provides that rights to perform obligations, or enforce rights, on behalf of a company, will not be restricted by the *ipso facto* stay (whether the 'step-in rights' are exercised directly by the contractual counterparty, on or its behalf by another person engaged to do so). It is also now clear that the right to 'step-in' does not need to be contained in the same contract as the right to be enforced, or obligation to be performed, on behalf of the insolvent company.

WHAT NOW?

We strongly encourage anyone entering into significant contracts with Australian counterparties to become familiar with the effect of the new *ipso facto* regime. In particular, you should:

- review your contractual documentation;
- consider whether the *ipso facto* regime could interfere with your contractual rights where a corporate counterparty enters a specified restructuring or insolvency procedure; and
- make any appropriate amendments to your contractual documentation, processes or policies to mitigate these risks or take advantage of any available exclusions.

For more information about how the new *ipso facto* regime might affect your business please contact any of the key contacts below.

ENDNOTES

1. See further discussion of this exception below.

2. It is unclear however why this exception also applies to the administration stay and the scheme of arrangement stay which, on their face, would not apply to receiver appointments.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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