

# National Innovation and Science Agenda – Exclusions from stay of enforcement of ipso facto clauses

16 May 2018

Corporations Policy Unit  
Consumer and Corporations Division  
The Treasury  
Langton Crescent  
Parkes ACT 2600  
Email [Insolvency@TREASURY.GOV.AU](mailto:Insolvency@TREASURY.GOV.AU)

**Contact:** David Turner  
President, NSW Young Lawyers

Leah Serafim  
Chair, NSW Young Lawyers Business Law Committee

**Contributors:** Priti Joshi (Editor), Olga Kubyk, Kate Samolej and Bronte Sellers (Editor)

The NSW Young Lawyers Business Law Committee (Committee) makes the following submission in response to the exposure drafts regarding the exceptions to the stay on enforcement of Ipso Facto clauses in commercial contracts.

## NSW Young Lawyers

NSW Young Lawyers is a division of The Law Society of New South Wales. NSW Young Lawyers supports practitioners in their professional and career development in numerous ways, including by encouraging active participation in its 15 separate committees, each dedicated to a particular area of practice. Membership is automatic for all NSW lawyers (solicitors and barristers) under 36 years and/or in their first five years of practice, as well as law students. NSW Young Lawyers currently has over 15,000 members.

The New South Wales Young Lawyers Business Law Committee (**Committee**) is a forum of like-minded individuals who have joined together to improve their own knowledge of business law and foster increased understanding of this area in the profession. The Committee reviews and comments on legal developments across corporate and commercial law, banking and finance, superannuation, taxation, insolvency, competition and trade practices.

## Summary of Recommendations

A key legislative intention behind the introduction of the *Treasury Laws Amendment (2017 Enterprise Incentives No 2) Act 2017* (Cth) (the **Amendment Act**) was to introduce a statutory stay on the enforcement of ipso facto clauses in commercial contracts, to give a company 'breathing space' during a scheme of arrangement, voluntary administration or the appointment of a receiver and manager or other managing controller (**Formal Process**), and allow companies to try and nurse their businesses back to good financial health.<sup>1</sup>

The exposure drafts for the *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018* (**Draft Regulations**) and *Corporations (Stay on Enforcing Certain Rights) Declaration 2018* (Cth) (**Draft Declaration**) now set out the exceptions to the stay of enforcement on ipso facto clauses in commercial contracts.

The Committee makes the following comments on some of the proposed exceptions to the stay which are within its knowledge and expertise, with particular regard to the Government's intentions behind introducing the statutory stay.

The Committee submits that:

---

<sup>1</sup> Explanatory Memorandum, Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, 25.

1. Clause 5.3A.50(b) of the Draft Regulations is too broad, permits all government licences and statutory permits to be excepted from the stay on enforcement of ipso facto clauses (not just those licences or permits where solvency was a precondition to the grant of the licence/permit) and should not be enacted. The clause is contrary to the legislative intention behind enacting the Amendment Act.
2. If clause 5.3A.50(b) of the Draft Regulations is to be enacted, the Committee submits that it should be modified to narrow its operation so that:
  - a. licences or permits that are crucial for the operation of a business subject to a Formal Process are excluded, in order to ensure that the exception maintains the legislative intention behind the Amendment Act; and
  - b. if the recommendation in 2a. above is not adopted, the clause be restricted so that it only applies to those permits/licences where solvency was a precondition to the grant of the licence.
3. The exceptions contained in Regulations 5.3A.50(2)(e)-(g) and (z)-(za) of the Draft Regulations should be adopted because ipso facto clauses in security arrangements are a commercial necessity for the function of this type of contract, and they act as mechanism to assist the secured party to mitigate their financial risk. It would be uncommercial for the stay on ipso facto clauses to extend to such contracts.
4. While the Committee agrees with the legislative intent behind Draft Regulation 5.3A.50(2)(l), the proposed regulation is too broad and can apply to all SPVs, not just those created for asset securitisation. This may enable parties to use SPV structures to bypass the statutory stay on the enforcement of Ipso Facto clauses. This is contrary to the legislative intention expressed in the explanatory statement accompanying the Draft Regulations.

## Introduction

The September 2017 amendments made by the Amendment Act to the *Corporations Act 2001* (Cth) introduced:

1. 'Safe harbour' provisions which offer directors protection from personal liability for insolvent trading, when developing and taking in a course of action reasonably likely to lead to a better outcome for the company ; and
2. A stay on the enforcement of self-executing ipso facto clauses in contracts.

The stay in point 2 above prevents a party to a contract from relying on ipso facto clauses where the counterparty is subject to a Formal Process. The Amendment Act also empowers the Court to extend the prohibition to prevent parties from exercising other rights in circumstances where an ipso facto clause is stayed but where the party may nevertheless terminate a contract due to non performance or default in payment.

The Draft Regulations and Draft Declaration set out the types of contracts and rights to be excluded from the operation of the mandatory stay of the ipso facto clauses.

## Government Contracts and Statutory Licences

Clause 5.3A.50(2)(b) of the Draft Regulations excludes Government contracts and statutory licences from the stay on enforcing ipso facto clauses.<sup>2</sup>

The Committee recommends that clause 5.3A.50(2)(b) of the Draft Regulations should not be enacted because this contradicts the legislative intention with which the Amendment Act was enacted. The accompanying Explanatory Memorandum to the Amendment Act states that ipso facto clauses ‘*reduce the scope for a successful restructure, destroy the enterprise value of a business entering into formal administration or prevent the sale of the business as a going concern.*’<sup>3</sup> It also states that ipso facto clauses can ‘*reduce or eliminate returns in liquidation because they disrupt the businesses’ contractual arrangements and destroy goodwill, potentially prejudicing other creditors and defeating the purpose of a voluntary administration.*’<sup>4</sup>

Clause 5.3A.50(2)(b) of the Draft Regulations has been drafted broadly, and if enacted could be devastating to the going-concern value of enterprises that rely on Government contracts, or statutory licences or permits, in the operation of their day to day business. In effect, the Draft Regulations allow government authorities to revoke a licence or a permit when a business is undergoing a Formal Process.<sup>5</sup> The Explanatory Statement to the Regulations states that this exception is to apply to licences or permits where solvency was a precondition of the grant of the licence, because this condition is in place to promote public safety and greater good of the community.<sup>6</sup> However, clause 5.3A.50(2)(b) is not restricted to those government contracts or licences where solvency was a precondition to the grant of the licence. This means that statutory licences such as liquor licences, gaming licences or food licences, which do not have solvency as a precondition to their grant, could be revoked by the issuing authority if the licensee entered into a formal restructure.

If, for example, the financial position of a business with a food licence deteriorated and an administrator was appointed, then this would not necessarily affect the business’ ability to maintain sanitary facilities, or maintain health standards during its operation, which are the conditions of the licence.<sup>7</sup> If a company is subject to a Formal Process, this does not automatically mean that the company cannot comply with its obligations under the licence, and does not mean that the company’s licence should be revoked. Having a business-critical licence revoked deprives the company and/or its external administrator of the opportunity for the business to improve its financial performance, or at least effect a sale of the assets of the business as a going concern. Therefore, the Committee submits that clause 5.3A.50(2)(b) should not be enacted.

---

<sup>2</sup> Exposure Draft – *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018* (Cth) cl 5.3A.50(2)(b).

<sup>3</sup> Explanatory Memorandum, *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017*, 25 [2.4].

<sup>4</sup> *Ibid* [2.5].

<sup>5</sup> Exposure Draft – Explanatory Statement, *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018*, 5 and 16.

<sup>6</sup> *Ibid*. 6.

<sup>7</sup> NSW Food Authority, *Licensing & notifying* (10 March 2018) NSW Food Authority <<http://www.foodauthority.nsw.gov.au/ip/licensing>>.

In an event that clause 5.3A.50(2)(b) is to be enacted, the Committee recommends that:

1. the clause be amended to exclude Government contracts, licences or permits that are crucial for the operation of the business in order to ensure that the exception maintains the legislative intention behind the Amendment Act; and
2. if the recommendation in 1. above is not accepted, the clause should be restricted so that it only applies to those permits/licences where solvency was a precondition to the grant of the licence.

## Financing Arrangements

The Draft Regulations exclude from the stay on enforcement certain ipso facto clauses relating to financing arrangements and arrangements whereby a company issues securities and/or offers securities pursuant to a rights issue.

The Committee submits that the exceptions in respect of financing arrangements, specifically the exceptions contained in clauses 5.3A.50(2)(e)-(g),(l) and (z)-(za) of the Draft Regulations should be adopted.

The exceptions set out within the Draft Regulations and the Draft Declaration, especially in respect to secured lending, concern themselves with managing credit risk. This risk mitigating function is a commercial necessity for the function of certain contracts.

This is particularly relevant to the acceleration of demands and guarantees. If an event of default was to occur enabling the secured creditor to call upon a sum owed by the other party, if the indebted party was not able to satisfy the demand, the same demand could be made upon a guarantor. If a stay was to be applied, then, depending on the terms of the loan contract and the guarantee, the secured party may be prevented from accelerating the principal debt, and consequently be unable to claim on the guarantee rendering the guarantee practically ineffective as security. This problem might practically be avoided if another default occurred (which, in respect of some Formal Processes, is likely to have occurred before the Formal Process commences anyway, such as the appointment of a receiver and manager by the secured creditor) and the provisions of the relevant contract allowed for acceleration of the debt on the basis of that default.

If the secured creditor was not able to accelerate the payment of a sum owed, it would not be able to enforce the guarantee unless the guarantee as a primary obligation, specifically provided that the guarantee could be called upon where the principal debt would have been accelerated, but for the statutory stay of enforcement of the ipso facto clause.

Further, it remains to be noted that set off and netting rights (as listed in clause 5.3A.50(2) of the Draft Regulations), are not able to be engaged until a debt comes due and payable by each counterparty.<sup>8</sup> Acceleration would often be able to bring about this state of affairs.

---

<sup>8</sup> *Hiley v Peoples Assurance* [1983] HCA 40; *Gye v McIntyre* [1991] HCA 60.

It is often the case that security arrangements involving sophisticated parties also involve special purpose vehicles (**SPV**) as a party to the contract. The Draft Regulations refer to contracts to which an SPV is a party, but do not define the term. Typically, SPVs are usually a company or a trust created for the purpose of the contract with few if any assets unrelated to the transaction, and are widely understood to be such in practice. The Explanatory Statement accompanying the Draft Regulations states that, contracts between sophisticated parties often include “a bespoke set of rules” regarding what is to occur in the event of the SPV’s insolvency (which may include ipso facto clauses) The Explanatory Statement accompanying the Draft Regulations gives the specific example of SPVs used for asset securitisation. However, the draft exception in clause 5.3A.50(2)(l) is not limited to SPVs used for asset securitisation purposes. While the Committee agrees with the policy intention behind the exception for SPVs used for asset securitisation purposes, the Committee submits that the draft exception is too broad and may permit parties to created SPVs with broad rules for the specific purpose of bypassing the statutory stay on ipso facto clauses. Again, this broad exception is contrary to the legislative intention behind the introduction of the Amendment Act.

## Concluding Comments

NSW Young Lawyers and the Committee thank you for the opportunity to make this submission. If you have any queries or require further submissions please contact the undersigned at your convenience.

### Contact:



David Turner  
President  
NSW Young Lawyers  
Email: david.turner@younglawyers.org.au

### Alternate Contact:



Leah Serafim  
Chair  
NSW Young Lawyers Business Law Committee  
Email: leah.serafim@younglawyers.org.au