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"Ipso Facto" clause reforms in formal insolvency - Draft exceptions

Proposed exceptions to the stay on enforcing *ipso facto* clauses now published; public consultation open

The reform

From 1 July 2018, the moratorium on reliance by solvent counterparties on "ipso facto" clauses in voluntary administration, certain receiverships and creditors schemes of arrangement will come into effect (unless it is proclaimed to commence earlier, which is not presently expected).

In summary, the ipso facto moratorium (or stay) will mean that there will be stays on the enforcement of rights against companies the subject of schemes of arrangement, voluntary administration and receivership if those rights have become enforceable only because of the fact of the company becoming subject to such arrangement. This prohibition include, for example, rights to terminate contracts or accelerate payments due by the debtor company due to such occurrences.

Where the operation of an ipso facto clause is stayed, the ability of the relevant company to enforce a right under a contract for new advances of money or credit is also stayed.

Obviously, the proposed stay - and any available exceptions to the stay, discussed below - is of considerable significance for a wide variety of contractual counterparties who may end up being stakeholders in formal insolvency situations.

You can read further detail on this reform (and the insolvent trading 'safe harbour' defence) in our earlier client note published in April 2017, available [here](#).

The proposed exceptions - certain "arrangements" and "rights" - good news for financiers and underwriters

Importantly, the provisions setting out the ipso facto regime include the ability for the Minister both to declare certain kinds of rights that will not be subject to the ipso facto stay and also to enact regulations to specify the kinds of arrangements where the rights in those arrangements will not be subject to the ipso facto stay. Where an arrangement is excluded from the stay under the regulations, all rights under that arrangement are excluded from the operation of the stay, whereas the excluded rights under the declaration are excluded irrespective of the type of arrangement they are contained in.

Exposure drafts of the proposed declaration and regulations (and their associated explanatory statements) have now been released, and the public is invited to make submissions .

The explanatory statements provide detailed commentary setting out the reasons for the inclusion of the various exceptions, and accordingly are a good source for assistance when interpreting the regulations and declaration.

Summary of excluded arrangements specified in the draft regulations

In summary, the arrangements proposed in the exposure drafts to be excluded from the ipso facto stay include:

- arrangements relating to the Convention on International Interests in Mobile Equipment (the 'Capetown Convention');
- government licences or permits;
- arrangements relating to securities and financial products, including:
 - derivatives;
 - arrangements for underwriting securities and financial products;
 - subscription agreements in respect of securities or financial products;
 - arrangements where an Australian company issues securities, or offers securities under a rights issue;
 - arrangements for the sale of all, or substantially all, of a business (including a sale by way of share purchase);
 - arrangements for issuances of securities or financial products belonging to a pre-1 July 2018 class of fungible securities or financial products (i.e. 'tapping' an existing issuance);
 - margin lending facilities;
 - arrangements for the issuing of covered bonds;
- complex arrangements between sophisticated parties, including arrangements to which a special purpose vehicle is a party, arrangements for keeping source code in escrow and arrangements for certain commercial charters of non-Australian ships;
- certain arrangements relating to debt and ranking of creditors, including subordination arrangements, flawed asset arrangements and factoring arrangements;
- arrangements relating to the operating rules of financial markets and certain arrangements relating to clearing and settlement facilities;
- certain netting and close-out arrangements, including in relation to approved RTGS systems; and
- arrangements arising as a result of exercising novation, assignment or variation rights in arrangements entered into before 1 July 2018.

Summary of excluded rights specified in the draft declaration

In summary, the types of rights proposed in the exposure drafts to be excluded from the ipso facto stay include:

- rights under a financing arrangement, or guarantee, indemnity or security related to a financing arrangement, entitling a counterparty to change the basis of calculation of an amount (e.g. default interest);
- rights to indemnities for costs, liabilities and loss incurred when preserving or enforcing rights;
- termination rights in a standstill or forbearance arrangement;
- rights to change the priority in which amounts are to be paid;
- rights of set-off, rights of combination of accounts and rights to net balances;
- rights of assignment and novation;
- self-executing provisions in respect of circulating assets and chattel paper; and
- certain step in rights.

Additional thoughts on specific exclusions

The regulations and declaration do not include any real surprises. While some exceptions are very specific in respect of the arrangements to which they apply, others are more general in their application. The exclusions in general favour financiers and underwriters.

It is also noteworthy that business and share sale agreements are included as exceptions - this removes material uncertainty for M&A practitioners.

Special Purpose Vehicles?

One exception that is likely to be the focus of further analysis and discussion, in the course of the public consultation process, is the exception for arrangements to which a special purpose vehicle is a party. The exposure draft explanatory statement for the regulations notes that a special purpose vehicle is a company, trust or partnership that is created to carry out a specific business purpose or activity and focuses on asset securitisation arrangements when discussing this exception.

However, the drafting of the relevant regulation itself is very wide and is potentially open to broader interpretation, taking the exception well beyond securitisation vehicles and into other areas such as leasing, infrastructure projects, leveraged finance, real estate development and the like. The width of the current draft may even encourage the use of special purpose vehicles in new transaction structures simply in order to take advantage of this exception. In our view, this particular exception is likely to be revised in the next draft of the regulations.

Next steps

Baker McKenzie is preparing a submission on the exposure drafts and comments are welcome. Please get in touch with one of the contacts set out below if you would like to comment or discuss the reform and its impact on your business further.

Submissions on the exposure drafts are due by 11 May 2018.

Kind Regards,



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