# IMPENDING CHANGES TO CONTRACTUAL TERMINATION RIGHTS (IPSO FACTO REFORMS) AND ITS IMPACT ON LEASES AND OTHER PROPERTY TRANSACTIONS

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In this newsletter, we will explore how the new impending ipso facto reforms, which come into effect on 1 July 2018, could affect landlords under commercial leases or parties under other contractual arrangements.

## WHAT ARE THE IPSO FACTO REFORMS?

The ipso facto reforms seek to prevent certain termination and other ipso facto rights under a contract from being enforced against a counterparty:

- when the counterparty enters administration
- where a managing controller has been appointed over all or substantially all of the counterparty's property
- where the counterparty is undertaking a compromise or arrangement for the purpose of avoiding being wound up in insolvency
  or
- on the occurrence of some other described 'insolvency event' (usually defined to include the counterparty being unable to pay debts as and when they fall due or entering into, or taking preparatory steps towards entering into, receivership, administration or a scheme of arrangement).

These rights in contracts are commonly known as 'ipso facto clauses'.

Such provisions are commonly found in many commercial leases, development agreements and other dealings. Ipso facto clauses are a risk mitigation tool designed to allow one party the opportunity to avoid any formal or informal insolvency process that is being undertaken by the other party to protect its interests arising from the documented transaction.

## HOW WILL THE REFORMS WORK?

The ipso facto reforms do not apply to contracts entered into before 1 July 2018 or to a variation, assignment or novation of a pre-1 July 2018 contract after that date.

For contracts entered into on or after 1 July 2018, the reforms will prohibit a party from relying on ipso facto clauses where a counterparty enters into administration or a scheme of arrangement, or its financial position if the

counterparty is subject to one of these insolvency processes. The reforms will also apply to 'self-executing' provisions (i.e. automatic termination clauses). Under the reform, ipso facto clauses are not unlawful (and so they should be retained in contracts) – they just cannot be enforced for the duration of the relevant insolvency event.

It is also important to note that the reforms also include anti-avoidance measures. These measures seek to prevent a party from exercising contractual rights against a counterparty if it appears likely that those rights are only exercised because of an insolvency event or the counterparty's financial position.

For example, if:

- Party A does not take an action against Party B for a breach
- Party B subsequently becomes insolvent
- Party A then seeks to terminate for Party B's earlier breach.

Then Party A may be deemed as only taking action as a result of Party B's insolvency and not for Party B's earlier breach, and such action would be prohibited.

However, certain rights and certain types of contracts will be excluded from the ipso facto reforms by regulation, including contracts entered into after the commencement of an insolvency process (such as administration) takes effect.

## WHAT DOES THIS MEAN FOR PARTIES TO DOCUMENTS?

When the reforms take effect and where a contract contains an ipso facto clause, a landlord under a lease or a party to another type of contract (such as a development agreement) cannot terminate the contact due to the appointment of administrators or receivers over the counterparty, provided that the counterparty complies with its obligations under the contract.

However, the reforms do not prevent landlords or other parties to contracts from exercising other rights to terminate the lease or contract when tenants or counterparties are in breach. Note though that, as per the anti-avoidance provisions, parties may be restricted from exercising those rights if it appears likely that those rights are only being exercised because of an insolvency event.

Accordingly, it is critical that parties remain vigilant during the term of the leases or other contractual arrangements for any breaches caused by the counterparties and actively enforce (and if applicable, reserve) rights in relation to those breaches. This is to assist in preserving rights for such other breaches should an insolvency event occur.

It is also critical that parties ensure they have adequate security (ideally bank guarantees) against counterparties so that if an insolvency event occurs, there is some form of recourse available in order to minimise losses, should a counterparty fail to trade out of its insolvent position.

## KEY CONTACTS

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