

A STAY OR NO STAY, THAT IS THE QUESTION

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On 1 July 2018, the stay on ipso facto clauses introduced by the *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017 (Act)* came into effect and will apply to contracts entered into on or after that date. The Act, left a number of issues up in the air which were expected to be filled by regulations. Those regulations, and a declaration, were released in late June 2018, providing little time for contracting parties, and their advisors, to understand how the new laws would impact them before their commencement.

THE STAY

Ipso facto clauses generally allow a party to enforce a right typically to terminate on the occurrence of an insolvency event to a counter party to the contract. The exercise of such rights could often be the nail in the coffin for companies entering into formal restructuring arrangements where those companies rely heavily on their contracts with suppliers and customers.

The stay was therefore introduced to give companies in formal restructuring arrangements the best opportunity to trade out of their financial distress.

CONTRACTS TO WHICH THE STAY DOES NOT APPLY

The *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018 (First Regulations)* sets out a lengthy list of contracts to which the stay will not apply. These contracts broadly include (among a number of other contracts):

contracts with government bodies;

contracts relating to securities, derivatives, bonds and other financial products;

contracts providing for the management of financial investments;

a contract in which the priority interests in particular property is affected; and

contracts and arrangements under the Payment Systems and Netting Act 1998.

A significant criticism of the Act was that the stay could be circumvented by parties varying and extending existing contracts that were entered into prior to 1 July 2018. The First Regulations now addresses this issue by providing that the stay will not apply to the following:

a contract, agreement or arrangement entered into or renewed on or after 1 July 2018, but before 1 July 2023, as a result of either of the following:

the novation of, or the assignment of one or more rights under a contract, agreement or arrangement entered into before 1 July 2018;

a variation of a contract, agreement or arrangement entered into before 1 July 2018.

This, in effect, creates a sunset date after which time parties will not be able to vary existing contracts so as to be able to rely on ipso facto clauses in those agreements.

The sunset date also applies to building contracts where the total sum of contracts for the building project exceeds \$1 billion.

The *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations (No. 2) 2018*, released one week after the First Regulations, amends a provision in the First Regulations to exclude from the effect of the stay contracts relating to the supply of essential or critical goods or services to a government body.

RIGHTS WHICH ARE NOT AFFECTED BY THE STAY

In late June 2018, the Commonwealth Parliament also released the *Corporations (Stay on Enforcing Certain Rights) Declaration 2018 (Declaration)* which contains a list of contractual rights which will not be affected by the stay. Some of the rights which will not be affected include:

the right to charge default interest;

the right to terminate a forbearance arrangement;

contractual set-off rights; and

a right to assign, novate or otherwise transfer rights and obligations.

The Declaration also provides for circumstances in which the right to appoint a receiver will not be affected by the stay.

A receiver can still be appointed by a secured creditor over property of a company where it enters into a Part 5.1 arrangement or reconstruction (for example a scheme of arrangement), where that creditor has security over all or substantially all of the assets of the company.

Further, a receiver can be appointed by a secured creditor where an inferior secured creditor has taken steps to appoint a receiver to the property of the company. It should also be noted that a secured creditor which has security over all or substantially all of the assets of the company still has the right to appoint a receiver during the decision period (as that term is defined in the *Corporations Act (Cth)*) where the debtor company has been placed into administration.

Contracting parties should be aware that even where the stay operates, a party will still be able to terminate the contract for other defaults, including monetary defaults and non-monetary defaults. Moreover, and as a further relief to financiers, the financially distressed company will not be able to exercise a right against the financier for a new advance of money or credit during the period of the stay.

PRACTICAL IMPLICATIONS

The regulations and the Declaration have added further certainty around the extent of the operation of the stay on *ipso facto* rights. The carve outs to the operation of the stay are significant and, in terms of the contracts to which the stay does not apply, are generally justified due to the nature of the goods or services to which those contracts relate.

In relation to those contracts to which the stay will apply, it remains to be seen whether the stay will have the effect of granting relief to financially distressed companies looking to revive themselves through formal restructuring processes. This is particularly so given contracting parties will still be able to enforce their contractual rights for default of monetary obligations, which are generally challenging for companies in those circumstances to meet.

Moreover, despite the stay, *ipso facto* clauses should remain in contracts as they may still grant enforceable rights.

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