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FINSights: *Insolvency shake-up to impact financiers*

Some of the most far-reaching Australian insolvency law changes are taking effect. These new laws will restrict the enforceability of a whole class of common clauses in contracts – so called 'ipso facto' clauses. In this edition of FINSights, we explore what these changes mean for financiers, and outline key tips and issues they should consider as we move forward into the new regime.

What are ipso facto clauses?

Clauses that allow one party to terminate or modify a contract when a specific event occurs, regardless of continued performance by the other party. Examples include rights to:

Accelerate a loan or debt on default

Enforce a security interest

Call on a bank guarantee or performance bond

Charge default interest

Terminate the contract *eg. a swap or lending commitment*

What circumstances restrict enforcement?

You cannot enforce a right under an ipso facto clause **if** the right arises from the trigger events noted below. Ipso facto clauses triggered by any of these events are 'stayed'.

The Trigger events are: (1) voluntary administration, (2) receivership over all assets, (3) creditors' scheme of arrangement, and (4) events related to the party's financial position (if any of 1 to 3 above has also occurred).

The new law is not a reason to remove ipso facto clauses from finance contracts. They will still work, absent a current trigger event.

WHY?

- Intended to give companies breathing space to implement a restructuring plan
- Supports VA work out regime by preventing termination of vital contracts during administration

WHEN?

- Stay applies to ipso facto clauses in contracts which are entered into on or after 1 July 2018
- Does **not** apply to contracts made before 1 July 2018

Exclusions

- **Carve outs by regulation or declaration:**

Some contracts with SPVs	Syndicated loans	Derivatives and netting
Flawed asset arrangements	Offer, underwriting and subscription agreements	Novating, assigning some pre-July contracts
Uplift clauses: eg default interest, grid pricing	Set-off and combination	Margin lending facilities

- **Drawstop**

A lender is not obliged to fund an undrawn commitment under a facility agreement while a stay is in place.

- **Negative pledges**

A simple negative pledge restriction (for example not to grant security) should not be affected.

What financing clauses will be affected?

Default rights arising from:

- Insolvency
- Financial covenant breaches
- Rating downgrades
- Material Adverse Event (if related to financial position)
- (sometimes) Cross default

Affecting default rights to (among others):

- Accelerate debt or enforce security
- Terminate a lending commitment
- Revalue an asset
- Apply insurance proceeds in debt reduction
- Lock up distributions and equity returns.

TIPS & ISSUES FOR FINANCIERS TO CONSIDER

- **Competing debt**: does your borrower have any facilities or note issues that will not be stayed (eg pre-July debt)?
- **Default events**: are there critical events which should be defaults, unrelated to the borrower's financial position?
- **Revolving facilities preferred**: rollover loans need not be readvanced (potentially giving rise to a payment default).
- **Syndicated loans**: syndicated loans exempted.
- **Special purpose vehicles**: contracts with SPVs in securitisation and project finance transactions exempted. Structure accordingly!
- **Security considerations**:
  - Cash retention accounts effectively exempted, and should be able to be accessed during a stay.
  - All asset security has significant advantages.
- **New rules will also apply to trustee borrowers** (even if the trust is not affected by trustee insolvency).
- **Third parties**: Termination of contracts with third parties (builders, lessees, purchasers etc) more difficult.

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