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NEW IPSO FACTO LAWS
WHAT DOES IT MEAN FOR YOU?

The Federal Government's new ipso facto laws, which were introduced by the *Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017* (Cth), impose an automatic stay on the enforcement of ipso facto clauses in certain contracts entered into on or after 1 July 2018.

In this insight, we summarise the new laws and take a closer look at how the reforms affect particular types of transactions. We also provide some practical tips for drafting and managing contracts affected by the new laws.

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WHAT IS AN IPSO FACTO CLAUSE?

An ipso facto clause is a contractual clause that confers a right or is self-executing (ie applies automatically for one or more reasons without any party making a decision that the provision should start to apply) merely because a specified event (typically an insolvency event in respect of a party to the contract) has occurred. An example of an ipso facto clause is a clause in a supply contract that permits the customer to terminate the contract, or modify payment terms, if the supplier enters a formal insolvency procedure such as voluntary administration.

WHEN DOES THE AUTOMATIC STAY APPLY?

In summary, where a company (**Company**) becomes subject to certain insolvency procedures (ie enters voluntary administration, has a controller (including a receiver) appointed to all or substantially all of its assets or publicly announces, applies for or becomes subject to a scheme of arrangement (designed to avoid an insolvent winding up)), then an automatic stay (**Automatic Stay**) will apply.

While the Automatic Stay applies, counterparties will be restricted from enforcing against that Company certain ipso facto rights and self-executing provisions arising under certain contracts, agreements and arrangements entered into on or after 1 July 2018 (with some exceptions), to the extent that the counterparty is doing so merely:

+ because the Company becomes subject to one of the specified insolvency procedures;
+ because of the Company's financial position (where it becomes subject to a specified insolvency procedure); or
+ because of some other prescribed reason.

The scope of the Automatic Stay, and specifically, what is excluded from its operation, has been the subject of extensive public consultation and has culminated in the following:

+ the *Corporations (Stay on Enforcing Certain Rights) Regulations 2018* which prescribe 42 types of contracts as excluded from the operation of the Automatic Stay; and
+ the *Corporations (Stay on Enforcing Certain Rights) Declaration 2018* which declares 11 types of rights and self-executing provisions as excluded from the operation of the Automatic Stay.

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WHAT IS THE RATIONALE FOR THE REFORMS?

The existence of ipso facto clauses means that upon a Company entering into a formal restructuring or insolvency procedure in Australia, its counterparties will seek to terminate the terms of their contracts with the Company often without regard to the Company's ability to continue meeting its obligations under those contracts. Where this occurs in respect of a Company's key commercial contracts, it can result in significant value destruction for the business concerned. Therefore, achieving a viable going concern turnaround for that Company has been very difficult within Australia's restructuring and formal insolvency framework.

In introducing these reforms, the Federal Government is seeking to maintain the value of businesses within Australia's restructuring and formal insolvency framework, by limiting the ability of counterparties to exercise their ipso facto rights purely on the basis that a Company has become subject to certain insolvency procedures.

For those who are not yet familiar with the new ipso facto laws, and would like to understand how they work, please click here.

For more information about exclusions from the laws and how the new laws will affect particular types of transactions, please click here.

For some practical tips for drafting and managing contracts affected by the new laws, please click here.

HOW DO THE NEW IPSO FACTO LAWS WORK?

When does the automatic stay apply?

The new laws apply where one of the following insolvency events (**Affected Procedures**) occurs in relation to a Company:

+ voluntary administration (see new sections 451E-451H added to Part 5.3A of the *Corporations Act 2001* (Cth) (**Corporations Act**));
+ a receiver or controller is appointed to all or substantially all of its assets (see new sections 434J-434M added to Part 5.2 as well as amendments to sections 441A(3), 441B(2), 441C(2) and 441E of the Corporations Act); or
+ it publicly announces, applies for or becomes subject to a scheme of arrangement (designed to avoid an insolvent winding up) (see new sections 415D-415G added to Part 5.1 of the Corporations Act).

Which rights are stayed and which rights can be enforced?

Upon the occurrence of an Affected Procedure, there will be an Automatic Stay (**Automatic Stay**) restricting the ability of a counterparty to enforce against the Company <u>certain</u> ipso facto rights and self-executing provisions arising under <u>certain</u> types of contracts, agreements and arrangements entered into on or after 1 July 2018 to the extent the third party is doing so (and such rights or provisions expressly arise or start to apply), because of one of the following triggers (**Potential Triggers**):

+ the Company becomes subject to an Affected Procedure;
+ the Company's financial position, if the Company is also subject to an Affected Procedure;
+ a prescribed reason relating to the Company becoming or possibly becoming subject to an Affected Procedure or its financial position, if the Company later becomes subject to an Affected Procedure; or
+ a reason that is, in substance, contrary to the Automatic Stay.

Not all rights and self-executing provisions will be subject to the Automatic Stay. During the period of the stay (**Stay Period**), it will still be possible for counterparties to enforce, for example:

+ rights arising due to a performance breach such as a payment default (unless that breach is only the occurrence of a Potential Trigger);
+ rights that are (or arise under contracts that are) prescribed in regulations or by ministerial declaration (see below for discussion of the Regulations and Declaration passed by the Federal Government);
+ rights arising under contracts entered into after the day that the order approving the scheme takes effect, the receiver or controller is appointed or the Company enters administration (as applicable) (that is, contracts entered into by the external administrator on behalf of the relevant Company); and
+ where the scheme administrator, receiver or managing controller or voluntary administrator (as applicable) has consented in writing to the right being enforced.

It is also possible for an aggrieved counterparty to apply to court to have the Automatic Stay lifted in respect of one or more of its rights against a Company. Courts can make such orders if satisfied that doing so is in the interests of justice or, in the case of a scheme only, the relevant scheme is not for the purpose of the Company avoiding being wound up. In making any such order, we would expect the court to weigh the importance of the contract to the business of the Company against the detriment that is being suffered (or potential detriment that may be suffered) by the counterparty as a result of not being able to enforce its rights.

In addition, courts will be able to make orders that a potentially broader range of rights and self-executing provisions (e.g. termination for convenience rights) are enforceable against the Company only with the court's leave and in accordance with such terms (if any) as the court imposes.

As a quid pro quo, whilst the Automatic Stay is in place, the Company will not be able to require its creditors to provide new advances or credit (where applicable) under contracts affected by the Automatic Stay.

How long is the Automatic Stay?

The length of the Automatic Stay depends on which of the Affected Procedures applies to the Company as follows (subject to courts order extending the stay):

In the case of a scheme of arrangement:

the stay will end within 3 months of the announcement, or where an application is made within that 3 months, when the application is withdrawn or dismissed by the court or when the scheme ends or the Company is wound up;

In the case of a receivership or managing controllership:

the stay will end when the receiver's or managing controller's control ends; and

In the case of a voluntary administration:

the stay will end on the latest of when the administration ends or the Company is wound up.

Importantly, the Automatic Stay does not apply once, or if, a Company executes a deed of company arrangement (**DOCA**). The Stay Period ends when the "administration ends", that is when a DOCA is executed by the Company and the Deed Administrator. Accordingly, if a Company does execute a DOCA and needs the protection of the Automatic Stay, then subject to limited exceptions, it will need to obtain Court orders.

Further, affected ipso facto rights and self-executing provisions will remain unenforceable indefinitely (i.e. beyond the expiry of the relevant Stay Period) to the extent that a counterparty is seeking to enforce its rights because of:

+ the Company's financial position before the end of the Stay Period;
+ the fact that the Company became subject to an Affected Procedure prior to the end of the Stay Period; or
+ a reason prescribed in regulations relating to the circumstances in existence during the Stay Period.

These circumstances are particularly significant because they will preclude counterparties from enforcing ipso facto provisions by reference to earlier events once the Automatic Stay has lapsed. According to the Explanatory Memorandum, these provisions were included to prevent the "perverse outcome" of a clause in an agreement that is stayed during an external administration being used against a Company once it has been successfully restructured, on the basis that it experienced some form of external administration during that restructuring process.

WHAT TYPES OF CONTRACTS AND RIGHTS ARE EXCLUDED FROM THE IPSO FACTO LAWS?

The scope of the Automatic Stay and specifically what is excluded from its operation by regulation and declaration has been the subject of extensive public consultation. That consultation has culminated in the following :

+ the Corporations (Stay on Enforcing Certain Rights) Regulations 2018 (Regulations) which prescribe 42 types of contracts as excluded from the operation of the Automatic Stay; and
+ the Corporations (Stay on Enforcing Certain Rights) Declaration 2018 (Declaration) which declares 11 types of rights and self-executing provisions as excluded from the operation of the Automatic Stay.

There is a 5 year transitional period for variations or novations/assignments of pre-1 July 2018 contracts (ie if the variation, novation or assignment is entered into before 1 July 2023). (See our further comments on this transitional period below.) Otherwise, a party to contract, agreement or arrangement caught by the Automatic Stay will not be able to enforce an ipso facto right unless the contract falls within one of the exclusions in the Regulations or the relevant right is covered by the Declaration.

The impact of the ipso facto laws is far reaching and the application of the Automatic Stay is subject to the sometimes ambiguous wording of each exception in the Regulations or Declaration.

NOVATING AND ASSIGNING RIGHTS IN RESPECT OF, OR OTHERWISE VARYING, PRE-1 JULY 2018 ARRANGEMENTS

The Regulations provide that the Automatic Stay does not apply to arrangements entered into on or after 1 July 2018, but before 1 July 2023, where those arrangements are:

+ a novation or an assignment of rights under an arrangement entered into before 1 July 2018; or
+ a variation of a contract, agreement or arrangement entered into before 1 July 2018.

This carve out demonstrates that the Automatic Stay was never intended to capture new arrangements entered into as a result of rights that were already on foot (or subject to existing contractual arrangements) when the ipso facto regime came into operation. Thus, the effect of this provision is that new arrangements entered into on or after 1 July 2018 stemming from novation or assignment rights in pre-1 July 2018 arrangements, or variations effected on or after 1 July 2018 to contracts entered into before 1 July 2018 , will not be captured by the Automatic Stay for a five year "grace period".

The effect of this is essentially the creation of an exception to the grandfathering of pre-1 July 2018 contracts and, despite its best intentions, it is likely to have a significant impact on long-term contracts and arrangements entered into pre-1 July 2018. For example, parties will be incentivised to use this "grace period" to extend or vary contracts entered into before the legislation became effective so that their tenures are extended beyond the five year period. While this gives some parties options, there are also likely to be parties with long-term contracts predating the legislation that will seek to assign, novate or vary them post 1 July 2023 unaware of the consequences (which may be bringing such contracts or arrangements within the ambit of the Automatic Stay).

The intention of this grace period is to provide parties with some time to consider how to best structure their affairs but that assumes that there is an obligation, or even an opportunity, to cause the contracts to be renegotiated. This is not always the case and parties should proceed with caution when dealing with long-term contracts entered into pre-1 July 2018. It makes sense for parties to examine (at the very least) critical long-term contracts existing at 1 July 2018 during (or when approaching the end of) the grace period to consider if steps can be taken to ensure they can take advantage of any opportunities for renegotiation during the grace period so that such contract's terms will be adequate in the event the contract becomes subject to the Automatic Stay post 1 July 2023. If not, it may be that such contracts or arrangements become an exception to the grandfathering provisions and are at the mercy of the Automatic Stay.

WE HAVE SET OUT BELOW KEY EXAMPLES OF THE APPLICATION OF THE NEW LAWS TO MORE COMMON TRANSACTIONS WE ADVISE ON AT G+T

Equity capital markets (ECM) and mergers and acquisitions (M&A)

A number of key ECM and M&A arrangements are carved out from the Automatic Stay including underwriting agreements, subscription agreements, rights issues, business sale agreements (including share sales) and financial investment management agreements. However, the extent of the implications of the new laws for entrenched rights (such as compulsory sale regimes triggered by an insolvency event) in shareholders/unitholders agreements, option agreements and convertible notes are less clear.

The Regulations are broadly drafted to extend the carve out from the Automatic Stay to contracts, arrangements and understandings which are, or govern, securities and financial products (as well as bonds, promissory notes and syndicated loans). The Explanatory Statement suggests that this Regulation was intended to ensure "Australian institutions" could continue to enforce rights based on events of default that are "typical and long-accepted in financial markets" (thereby avoiding any adverse impact on Australian companies seeking to access that capital).

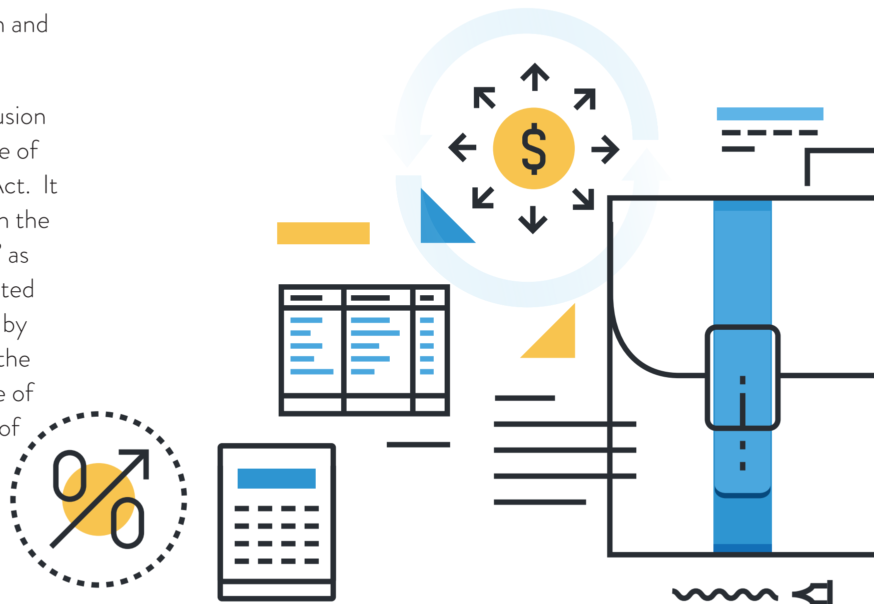
We consider that this policy rationale of allowing long-accepted rights to be enforced should extend to the contractual framework governing decisions to provide equity capital which typically includes both subscription and shareholder agreements in the context of shares.

In the context of public M&A, there is no express exclusion for contracts which are formed through the acceptance of takeover offers under Chapter 6 of the Corporations Act. It is not uncommon for such offers to be conditional upon the non-occurrence of so-called "prescribed occurrences" as set out in section 652C, which are typically supplemented by a range of insolvency events which would be caught by the ipso facto provisions. In our view it is arguable that the Regulation extends to contracts formed on acceptance of takeover contracts, consistent with the policy position of exempting the sale of securities.

The position in relation to schemes of arrangement under section 411 of the Corporations Act, which often incorporate the equivalent to "prescribed occurrences" clauses, is unclear. This is because scheme implementation deeds prescribe a process that leads to a Court order being made under that section (rather than strictly governing securities or financial products).

The contracts discussed above would benefit from clarifying amendments to the Regulations. The application of ipso facto provisions to these types of contracts should be discussed with your legal advisers as there may also be other protections to be considered until there is a court decision to clarify this issue or a market position emerges.

The potential inability of a purchaser to enforce ipso facto rights in the event that a counterparty becomes subject to an Affected Procedure is now an additional consideration to be assessed in due diligence of a target or issuer's contracts, particularly for potential financiers of an acquisition assessing its risk position in an enforcement scenario.



Debt finance contracts

Some key finance arrangements carved out from the Automatic Stay by the Regulations include transactions involving debt capital markets, syndicated loans, bonds, promissory notes, securitisations and derivatives. Some subordination and priority arrangements are also carved out so as not to interfere with the statutory waterfall of agreed priorities in insolvency and contractual agreements amongst creditors regarding priorities. Arrangements involving special purpose vehicles (SPVs) for Public Private Partnerships (or PPPs) or project financing are also excluded on the basis that such arrangements are typically negotiated between sophisticated counterparties who agree on a bespoke set of rules in the event of a party's insolvency.

Importantly, the Automatic Stay also does not apply to financing arrangements (being any contract, agreement or arrangement under which a person provides financial accommodation to a Company) insofar as they entitle the lender to charge a higher rate of interest following a relevant insolvency event. The effect of this is that a lender, in these circumstances, would not be prohibited from charging an "uplift" upon the borrower entering into a relevant insolvency event.

While the carve outs provide welcome relief for some finance parties, there are questionable omissions from the list of carve outs and questions as to the meaning of specified carve outs. Key finance arrangements remain for the most part subject to the Automatic Stay, such as bilateral loans, bank guarantees or bill discount facilities, even though these arrangements arguably also rely on the ability to enforce rights based on events of default that are "typical and long-accepted in financial markets". Similarly, parties should be mindful that the scope of arrangements which have been carved out from the Automatic Stay may be judicially interpreted with a different or narrower meaning to that commonly understood in finance markets. For example, syndicated loans, securitisation, project finance arrangements and SPVs, while discussed in the explanatory materials, should be carefully considered. Likewise, parties should also step back to assess the overall finance structure to determine the interaction of rights between creditors who may or may not be subject to the Automatic Stay. The implications of a cross default as between finance parties should also be analysed.

Energy and resources

With two notable exceptions, the vast majority of agreements relating to the energy and resources sector will be affected by these reforms.

The first notable exception is the exclusion from the Automatic Stay of licences, permits or approvals issued by the Commonwealth, a State or Territory or an authority of the same. This clearly captures mining tenements and oil and gas permits as well as related approvals, thus enabling those Governments and authorities to rely on any rights they have arising as a result of an Affected Procedure.

The other notable exception is the exclusion from the Automatic Stay of a sale of all or part of a business (including share sales). Provided it fits within this exception, a traditional sale arrangement will not be subject to the Automatic Stay. What is not clear is whether this will apply to other disposal arrangements such as option or farm-in agreements, both of which are common disposal vehicles used in the resources industry as they enable a potential acquirer to explore the area in question before being committed to acquire the applicable interest. The commentary in the Explanatory Statement talks only of sale of a business as an alternative to a formal insolvency process and the impact a stay would have on the purchase price in that instance. In that light, and given the grant of an option or farm-in right would not ordinarily be considered to be a "sale", we do not consider the Regulation was intended to extend to such arrangements. There may however be more scope to argue that this Regulation applies to those farm-ins structured as an up-front transfer as is common in the oil and gas industry.

Similrly, other agreements relating to energy and resources tenure or projects, such as access and/or licence agreements and mineral sharing arrangements are not the subject of any exceptions contained in the Regulations.

Importantly, in relation to the primary vehicle for joint ownership of energy and resource projects in Australian, unincorporated joint ventures, it is clear that these are not the subject of an exception in the Regulations. However, this is less clear in the case of incorporated joint ventures which are governed

by shareholder agreements. As noted in the ECM and M&A section above, there may be scope to argue that shareholders agreements are carved out on the basis that they are contracts, arrangements and understandings which are, or govern, securities. Unfortunately the discussion in the Explanatory Statement centres around events of default accepted in financial markets which may otherwise affect Australian companies seeking access to capital and it is hard to reconcile this with the use of a shareholders agreement in the context of an incorporated joint venture for an energy or resources project. Until more clarity emerges on the scope of this exclusion, careful consideration should be given before relying on it in the context of these agreements.

Perhaps more concerning is the impact of the Automatic Stay on the cross-securities that are typically granted to secure performance under joint venture and joint operating agreements. Under these arrangements the secured property is usually limited to the assets associated with the joint venture only and not all of the property of the relevant joint venture party. As such there is at risk of the Automatic Stay applying to the appointment of a controller as the carve-out in the Declaration only applies where the controller is appointed to the whole or substantially the whole of the property of the relevant joint venture party. Careful consideration will need to be given to these arrangements in the future and we may see the emergence of a practice of creating featherweight securities as part of the cross security regime or other structuring changes to address this.

In addition to the agreements and arrangements listed above, other contracts in the energy and resources sector that will be affected by these reforms range from construction and services agreements , operating and supply contracts to offtake contracts and upstream arrangements. These agreements are commonly critical to the ongoing operation and viability of an energy and resources project and are precisely the kinds of contracts that reforms are trying to protect.

Given the limited application of the Regulations to the above arrangements, careful consideration should be given to the possible application of any of the rights carved out by the Declaration. One carve out that might be useful in the energy and resources context is the use of a step-in right as contemplated by the Declaration. This is likely to be critical in construction, services and operating contracts and we are likely to see an increased use of these rights in other agreements such as access licences and farm-in, joint venture and joint operating agreements as a result of these reforms.

The other likely impact of these reforms is the increased inclusion of specific and incremental performance obligations given counterparties will no longer be entitled to rely purely on an insolvency event trigger. Often inclusion of a broad insolvency event of default provides great comfort to a counterparty. In the absence of that, we expect to see parties revisit the risk and default matrix applied to a transaction and to see significantly greater attention given to the drafting of other events of default and related performance obligations. This may involve tighter timeframes for payment obligations but also increased specificity regarding non-monetary obligations seeking to alleviate the complications and risks that can arise when a counterparty enters into receivership or voluntary administration. For example, obligations to maintain tenements and permits in "good standing" or requiring compliance with "good operating standards" are likely to come under closer scrutiny. However, care needs to be taken lest one ends up with an agreement so full of triggers that it hinders its day to day operation.

Another important point to note arises from the often long-term nature of contracts in the energy and resources sector. Contracts entered into prior to 1 July 2018 are not subject to the Automatic Stay but only so long as they are not novated, assigned or varied with the effect of there being an entry into a new contract after 1 July 2023 (see further discussion above). This is particularly concerning in the case of existing joint venture and joint operating arrangements which will become subject of the Automatic Stay as soon as there is a novation or assignment after 1 July 2023 as these arrangements were not originally drafted with the Automatic Stay in mind. In some cases these will be part of a complex suite of related agreements affecting a project worth many millions of dollars. Parties to such long-term agreements should be considering this now to ensure they can take advantage of any opportunities to cause the agreements to be renegotiated prior to 1 July 2023.

Real estate and property contracts

The new laws are of particular significance in the Real Estate industry. It is common practice for ipso facto clauses to be present in contracts for sale of land or leases. These contractual safeguards protect sellers and landlords where the purchaser or tenant has been the subject of an insolvency event and the seller or landlord wishes to terminate the contract.

A typical ipso facto clause in a lease would permit a landlord to terminate the lease when an Affected Procedure (such as the appointment of an administrator to a tenant) occurs. The clause could go further to provide that certain commercial terms favourable to the tenant do not apply when such an insolvency event occurs. For example, the lease could provide that incentives provided under the lease such as rent free periods or fit out contributions would not apply where an Affected Procedure has occurred.

Under the new laws, as long as the tenant continues to comply with its obligations under the lease, the contract remains on foot regardless of an Affected Procedure occurring. However, if the tenant enters into liquidation or fails to perform any of its other obligations under the lease, the landlord is still entitled to exercise its rights under the lease.

Previously, section 440B of the Corporations Act prevented a lessor from taking possession of or otherwise recovering the premises of a tenant in administration without the leave of the court or the consent of the administrator. However, the Act did not provide for an effective suspension of all ipso facto clauses in a lease (as is the case now as a result of the Automatic Stay which applies to such ipso facto clauses).

In any event, the controls that landlords were previously permitted to include in a lease to apply in the case of an Affected Procedure have been reduced. Landlords and tenants should review the relevant insolvency and related provisions in their property documents to ensure that they have the full protection available under the new laws.

As discussed above, the new laws do not have retrospective effect. Contracts for Sale and leases entered into prior to 1 July 2018 will not be subject to the Automatic Stay provisions under the new laws. As such, landlords should consider variations or extensions of their previous leases during the 5 year transitional period as opposed to new contracts to ensure that they are not caught by the new regime. In contrast, tenants should insist on entering into new leases if any changes have been agreed between the parties.

Construction and infrastructure

Principals and head contractors should be aware that the usual catch-all contract definition 'Insolvency Event' which gives rise to termination rights or the right to call on security may be stayed as a result of the reforms. Enforcing ipso facto rights may result in liability for invalid repudiation if the stay should have applied.

The construction industry should note four relevant exceptions to the reforms.

First, initial optimism that the reforms would not apply to special purpose vehicles (SPV), a common contracting entity in infrastructure projects, has been tempered slightly by the qualification that the contracts must involve an SPV and either securitisation, a public-private partnership, or project finance.

Second, contracts will be carved out where they are for "building work" entered into before 1 July 2023 and with "total payments under all contracts" of at least $1 billion.

+ The definition of building work is broad and includes work that would come within the definition of "construction work" under section 5 of the NSW security of payment legislation. Certain types of work such as mining for gas, minerals or oil is excluded.
+ Why the threshold is $1 billion is anyone's guess. Experience shows that $250m projects are as commercial and complex as deals for $1 billion. Further, whether 'total payments' can be reliably ascertained at the start of a project is not clear. A $600m construction contract would be subject to the Automatic Stay, but the exception could be enlivened by a contractor experiencing cash flow issues who brings a $450m claim for delay, disruption and variations. The reforms may apply inconsistently across the industry and parties may not be aware that the application of the reforms to their project has changed.

Third, exceptions apply to public space projects for contracts relating to Australia's national security, border protection or defence capability but also for the supply of "essential or critical goods or services" or the carrying out of essential or critical works for government, or to the public on behalf of government. The exceptions also apply to public hospitals and public health services.

Finally, additional exceptions in relation to construction contracts include rights concerning set-off, step-in, and assignment, novation or transfer of rights for contracts entered into before 1 July 2018. This should provide comfort to construction finance parties that their tripartite agreements (or direct deeds) are likely to remain effective.

Among other exceptions, parties will still be able to exercise suspension and termination rights, and the right to call on security:

+ for contracts entered into before 1 July 2018;
+ for reasons unrelated to the other party's external administration or financial position;
+ for particular types of insolvency such as liquidation; and
+ with the written consent of the administrator, liquidator, receiver, or pursuant to a court order.

Parties should be aware that termination for convenience clauses may be caught by the Automatic Stay if a principal elects to terminate for convenience at the same time that a contractor experiences an insolvency event. The intent of the legislation is to prevent automatic termination but until there is judicial guidance, parties should ensure that they can justify termination for convenience if the counterparty is under external administration.

The public policy driving the reforms is aimed at helping contractors to trade out of trouble by preventing automatic termination, therefore preserving the benefit of revenue-producing contracts. But these reforms apply at all levels across a project. Construction parties may find themselves unable to respond efficiently when dealing with administered contractors and subcontractors.

The exceptions available to mega projects leave the majority of small- to medium-scale construction projects exposed to the Automatic Stay. Despite the surge in renewables investment, in which most projects are well below $1 billion, parties should review their contracts and seek appropriate amendments to mitigate the risks arising from the reforms. As the reforms are so contractor-friendly, it may be difficult to negotiate such amendments. However, given the uncertain application of the exceptions, we think it is likely there will be further refinements in the future, either by amendment or a court.

Technology and Digital

There are a number of significant carve outs of the Automatic Stay regime that have particular relevance to technology contracting. The new Regulations prescribe relevant carve outs in relation to escrow and step-in arrangements, as well as government contracts for the procurement of information or communications technology. This is significant, as insolvency is often the trigger for a range of provisions, including for release of software code under escrow provisions, or for the exercise of step-in rights. The Regulations stipulate that a number of specific types of technology-based contracts are exempt from the Automatic Stay regime, including:

+ (government contracts for the supply of essential or critical information technology or communication technology products and services;
+ contracts for the supply of goods or services to public hospitals or public health services;
+ contracts that are outsourcing arrangements for the purposes of Prudential Standard CPS 231 Outsourcing or Prudential Standard SPS 231 Outsourcing; and
+ contracts for the keeping in escrow of code or passwords for computer software, as well as material directly related to such code or passwords.

Additionally, under the Declaration, step-in rights are also exempt from the Automatic Stay regime. This means that a contracting party that may otherwise be prevented from acting due to an Automatic Stay may exercise rights to step-in to perform the obligations of the specified person under the contract (or engage another party to do so), or enforce rights (or engage another party to do so).Of further note is that bank guarantees, which are often obtained by customers to protect against the default of the service provider, are not detailed in the Regulations as exceptions to the ipso facto laws. As such, customers may be unable to enforce such guarantees where the right is triggered by an insolvency event. However, the application of service levels and service credits will remain unaffected by any Automatic Stay.

Considering how reliant business and government has become on information technology, and the fact that service providers are ordinarily engaged to provide services on a long term basis, the application of the Automatic Stay regime has high potential to have a significant impact on customers who no longer have grounds to terminate due to a service provider's default. This will likely change the nature of how these clauses are negotiated and potentially have pricing repercussions for customers who are locked into these contracts.

PRACTICAL TIPS FOR DRAFTING AND MANAGING CONTRACTS CAUGHT BY THE AUTOMATIC STAY

When entering into a contract, arrangement or understanding that may be subject to the Automatic Stay, some key things to consider include:

DO NOT REMOVE ANY POTENTIAL IPSO FACTO CLAUSES
While an Automatic Stay makes ipso facto clauses inoperative while it applies, it does not affect the validity of such clauses. The ipso facto laws themselves provide a mechanism to apply to court to enforce the clauses or to have the administrator, controller or receiver consent to their enforcement.

CONSIDER ADDING QUALIFYING WORDS IN AN IPSO FACTO CLAUSE
to expressly state that it is subject to the ipso facto laws. The absence of such qualifying words will not affect the validity of the clause but is intended to put parties on notice of the Automatic Stay and may help mitigate the risk of agreements being wrongfully terminated.

CONSIDER WHETHER ANY INFORMATION UNDERTAKINGS AND PERFORMANCE BREACH PROVISIONS SHOULD BE BOLSTERED
This will help parties to monitor counterparty performance of obligations throughout the contract period as well as to document, and put the counterparty on notice of, any breaches.

CONSIDER OBTAINING A BANK GUARANTEE OR A GUARANTEE
from a parent company or personal guarantee from a director (although there may be some limits on the enforcements of such guarantees as mentioned above).

IN THE EVENT THAT AN AFFECTED PROCEDURE DOES OCCUR
in relation to a counterparty, it may be worth writing to the relevant external administrator to seek consent to the exercise of an ipso facto right.

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