



IpsO facto – encouraging turnarounds and preserving enterprise value

For as long as they have been in existence ipso facto clauses have destroyed value in commercial contracts.

They allow counter-parties to terminate or suspend contracts where an insolvency event occurs. This act is value-destructive for contract-reliant businesses and leaves stakeholders with significantly diminished returns.

Written into almost every contract is a termination provision, known as an ipso facto clause, that allows a counter-party to terminate or modify a contract in the event of an insolvency, bankruptcy or receivership for the settlement of either party's debts (even if there is compliance with all other contractual terms).

Enter the Enterprise Incentives Act

Passed through Senate on 11 September 2017, the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017 (Cth) ("Enterprise Incentives Act") is due to commence on 1 July 2018. Like the Safe Harbour reforms (also contained in the Enterprise Incentive Act), the ipso facto amendments look to promote a culture of entrepreneurship and successful turnarounds, by assisting viable, but financially distressed companies to continue to operate while they restructure their business.

Contracts entered into from 1 July 2018 will no longer be terminated, suspended, or modified due to insolvency. There will be limited exceptions contained in the accompanying regulations and declarations. These exceptions were recently debated by consultation, but are yet to be confirmed. It is hoped these amendments will preserve value in companies dependent on enforceable contracts to derive revenue and enterprise value.

The Enterprise Incentives Act prevents counter-parties from enforcing contractual rights to suspend or terminate contracts where, among other things:

- A company enters into voluntary administration, receivership, or where it proposes a scheme of arrangement.
- A company's financial position deteriorates due to an external administration.

The stay will remain in place until the various provisions of the Enterprise Incentives Act no longer apply under the respective circumstance.

Interestingly, the Enterprise Incentives Act is silent on receiverships not over the whole or substantially the whole of a company's property, deeds of company arrangement and liquidations that do not immediately follow an administration, or scheme.

Breathing room for some

These reforms are broad and contemplate a wide range of contracts. It appears to us that this legislation will be particularly relevant where significant enterprise value is tied up in contracts e.g. businesses in the mining services, civil engineering, construction, labour hire and professional services sectors. It will also mean that leases entered into from 1 July 2018, including leases entered into by trading businesses, cannot be terminated under an ipso facto clause. This will be beneficial for all sectors, including the retail sector, where we have seen a plethora of recent insolvencies.

Historically these companies have been left vulnerable when an insolvency clause had been breached. In that scenario, counter-parties could, subject to their contractual rights:

- terminate the contract;
- suspend works, or engage another contractor to complete the works; and/or
- not pay, or offset any amounts outstanding against any counter-claims.

These new provisions will prevent this from occurring, giving businesses reliant on contracts breathing space while they attempt a turnaround, or to sell the business with enforceable contracts on foot.

To retain or negotiate

Any pre-1 July 2018 contracts remain subject to contractual ipso facto rights.

Accordingly, businesses should review all their contracts to understand what these new provisions may mean for them and seek appropriate advice. A business will be able to weigh up which is more important; retaining its current rights under existing agreements, or invoking the proposed protections.

If a business wants to retain its current contractual rights, it may want to vary current agreements, or enter into new agreements before 1 July 2018. This will ensure that any ipso facto provisions will still be enforceable – at least until the new contract expires.

Until the amendments come into effect, an interesting window exists. If a business is not concerned about retaining any ipso facto protections, it may want to engage with counter-parties now to remove those protections, in exchange for strengthening other provisions it views as more important in the long-term.

Invoking the new protections

If a business wants to protect itself from the current ipso facto regime, we recommend finalising any current contractual negotiations after 1 July 2018. New contracts will fall under the new amendments and a counter-party will be unable to terminate the contract if an insolvency event occurs, save for the specific exceptions discussed above.

Nonetheless, these new provisions will not prevent a contract from being terminated due to any other contractual breach such as non-compliance of a health and safety provision or a lack of performance.

How we can assist

FTI Consulting has broad industry expertise and a successful track record of assisting businesses experiencing disruption, including that driven by legislative change. If you have a client that would like to discuss these changes further, please contact us for a confidential discussion.

We can provide several services including restructuring, insolvency advice and appointments, litigation support, valuation, interim management, financial management and performance improvement solutions to assist your clients.

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