



GREENWAY CHAMBERS

Automatic termination – ‘ipso facto’ clauses & s451E of the Corporations Act 2001 (Cth)

1. Automatic termination clauses are often included in standard form contracts. They are commonly referred to as “ipso facto” clauses.¹ Typically, an automatic termination clause provides that if a party suffers a specified event of insolvency the contract is said to automatically terminate.
2. In the context of construction contracts, principals or head contractors typically insert ipso facto clauses into a contract enabling them to terminate in the event of the contractor or subcontractor suffering an insolvency event.
3. The introduction of the “Ipso Facto” legislative reforms (from 1 July 2018) may, depending on the date and type of contract, alter the operation of automatic termination provisions.
4. The stay provisions apply to all contracts entered into after 1 July 2018. The legislation does not have retrospective effect.
5. Importantly, parties cannot contract out of the legislation.² As a result, artificial contractual devices implemented to circumvent the legislation may fall foul of this prohibition.
6. The stay provisions were inserted into the Corporations Act as part of a wider suite of insolvency law reform changes intended to improve Australia’s financial rescue and restructuring landscape. The new provisions were intended to operate so that:³

“...contractual rights will be unable to be enforced against a company which is undertaking a formal restructure when the rights are triggered by the company’s

¹ “ipso facto” means by the fact itself.

² *Treasury Laws Amendment (2017) Enterprise Initiatives (No. 2) Act 2017*, Schedule 1, Part 1, s.7.

³ The Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprises Incentive No 2) Bill 2017 (at [2.9]).

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financial position or its entry into a formal restructure. That stay will continue indefinitely in circumstances where the event on which the right depended occurred before or during the formal restructure”.

Imposition of a stay

7. In broad terms, the reforms impose a stay on the enforcement of ipso facto clauses during a period of restructuring of a company. A stay is imposed on the exercise of a right to terminate as a result of companies that become subject to the following insolvency regimes:
 - a. voluntary administration;⁴
 - b. receivership - where a receiver or controller is appointed over the whole or substantially the whole of the property of the company;⁵ or
 - c. a creditors’ scheme of arrangement.⁶
8. The period of the stay depends on the type of insolvency event that has occurred.
9. A party seeking to lift, expand or extend the stay must apply to court.
10. However, the stay does not apply in the following circumstances:
 - a. where a receiver or controller is NOT appointed over the whole or substantially the whole of the property of the company;
 - b. a deed of company arrangement;
 - c. a liquidation (where the liquidation does not immediately follow a voluntary administration or creditor’s scheme).

⁴ Section 451E of the Corporations Act.

⁵ Section 434J of the Corporations Act.

⁶ Section 415D of the Corporations Act.

11. The legislative changes did not affect a counterparty's right to terminate or amend an agreement for another reason, such as a breach involving non-payment or non-performance.⁷

Excluded contracts

12. A vast range of exclusions apply so that certain contracts and contractual rights are excluded from the operation of the stay provisions.⁸ For example, types of contracts that are excluded include:
 - a. contracts for supply of goods or service to, or on behalf of, a public hospital or public health service;
 - b. contracts with the Commonwealth or a State for the supply of essential or critical goods or services.
 - c. contracts relating to Australia's defence or national security.

Excluded rights

13. The kind of rights that are excluded include a right to:
 - a. set off;¹⁰
 - b. assign rights or obligations;¹¹
 - c. novate rights or obligations under contracts entered into prior to 1 July 2018;¹²
 - d. perform obligations¹³ or to engage third parties to perform obligations;¹⁴
 - e. enforce rights¹⁵ or to engage third parties to enforce rights.¹⁶

⁷ Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprises Incentive No 2) Bill 2017 at [2.11].

⁸ Exceptions are contained in the 5.3A50(2) of the Corporations Regulations 2001 inserted with effect from 1 July 2018 by the *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations (No.2) 2018*.

⁹ Contained in section 5(4) of the *Corporations (Stay on Enforcing Certain Rights) Declaration 2018*.

¹⁰ section 5(4)(e) of the *Corporations (Stay on Enforcing Certain Rights) Declaration 2018*.

¹¹ section 5(4)(h)(i) of the *Corporations (Stay on Enforcing Certain Rights) Declaration 2018*.

¹² section 5(4)(h)(ii) of the *Corporations (Stay on Enforcing Certain Rights) Declaration 2018*.

¹³ section 5(4)(j)(i) of the *Corporations (Stay on Enforcing Certain Rights) Declaration 2018*.

¹⁴ section 5(4)(j)(ii) of the *Corporations (Stay on Enforcing Certain Rights) Declaration 2018*.

¹⁵ section 5(4)(j)(iii) of the *Corporations (Stay on Enforcing Certain Rights) Declaration 2018*.

¹⁶ section 5(4)(j)(iv) of the *Corporations (Stay on Enforcing Certain Rights) Declaration 2018*.

14. Therefore, if a contract entered into prior to 1 July 2018 was assigned or novated after that date, the stay provisions do not apply to it.
15. Further, the 'ipso facto' stay provisions do not apply to "step in rights" and the right to engage a third party to perform obligations or enforce rights. Step in rights allow counterparties to take on the rights and obligations of their counterparties. In construction contracts, these rights typically manifest in the power of a principal to "take work out of the hands" of a contractor to mitigate loss and engage other contractors to finish any outstanding work.

Stay relating to the appointment of a voluntary administrator - ss451E and 451F

16. Sections 451E and 451F of the Corporations Act were introduced by the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Act 2017, with effect from 1 July 2018.

The operation of sections 451E and 451F of the Corporations Act

When does the stay apply?

17. A stay on enforcing rights applies in at least the following circumstances:
 - a. to prevent enforcing rights if a company is under voluntary administration: s451E(1)(a) of the Corporations Act;
 - b. to prevent the operation of provisions for termination solely based on the company's financial position, where the company is in voluntary administration: s451E(1)(b) of the Corporations Act.
18. Therefore, unless the contract is an excluded contract, a right to terminate a contract entered into after 1 July 2018 will not be enforceable to the extent that those rights are triggered by the company coming under administration.
19. Austin & Black observe that the prevention of a provision for termination based on a company's financial position "...appears to function as an anti-avoidance mechanism,

where financial criteria might otherwise provide a substitute basis for amendment or termination in the context of a voluntary administration".¹⁷

When does the stay end?

20. The stay ends:
 - a. when the administration ends, i.e. when a deed of company arrangement is executed: s451E(2)(a); or
 - b. if the administration ends because of a resolution or order for the company to be wound up — when the company's affairs have been fully wound up:

Extending the period of the stay

21. The stay may be extended on application to the court on satisfaction that the extension is appropriate having regard to the interests of justice: s451E(3)(a) of the Corporations Act.
22. However, a right is unenforceable against a company indefinitely after the end of the stay period to the extent that a reason for seeking to enforce the right is any of the specified matters in s.451E(4) that arose before the end of the stay.

Court application to lift the stay

23. Section 451F allows the court to order the lifting of the stay if it is satisfied that that is appropriate in the interests of justice. The term "interest of justice" is not defined and therefore there is some uncertainty as to its meaning.
24. However, in exercising that power, a court is likely to have regard to the interests of the company and its creditors on the one hand and of the party seeking to enforce rights on the other, and possibly to a wider public interest in the success of restructurings.
25. Further, the court may well draw on the case law dealing with the stay on exercise of rights by secured creditors or lessors during an administration, at least by way of analogy:¹⁸

¹⁷ RP Austin, Hon Justice Black, *Austin & Black's Annotations to the Corporations Act*, LexisNexus [5.451E].

¹⁸ See [5.440B] of Austin and Black's Annotated Corporations Act.

26. In any event, the court has a wide discretion to extend the period of the stay, lift the stay or even extend the application of the stay to the enforcement of other rights that are not expressly caught by the wording of the legislation (e.g., right to terminate the contract for convenience) if it appears that those other rights will be exercised merely because of an insolvency event.
27. Section 451G allows the court to order that rights under a contract are enforceable only with the leave of the court and on such terms as the court imposes in specified circumstances.

Rathner, Re Citius Property Pty Ltd (Administrator Appointed) [2023] FCA 2 (O’Bryan J)

28. We have waited a long time for judicial consideration of the stay provisions of the Corporations Act. The first judgment concerning the ipso facto stay provisions of the Corporations Act has been delivered.

Facts

29. Citius Property Pty Ltd (**Citius**) is in the business of providing property management and consultancy services.
30. On 28 December 2022, a voluntary administrator was appointed to Citius.
31. Citius’ principal asset was an agreement with its landlord Dexus. The agreement was for the provision of project management services by Citius in connection with a commercial property development project in Victoria (**Dexus Agreement**).
32. The Dexus Agreement contained an ipso facto clause¹⁹ i.e., the Dexus Agreement could be immediately terminated upon the occurrence of an insolvency event (which was defined to include the appointment of administrator).

Application by the Administrator

33. The Administrator applied to the Court for an order pursuant to s90–15 of the Insolvency Practice Schedule (Corporations)(Schedule 2 to the Corporations Act) (**IPSC**), that the Administrator was justified and acting reasonably in proceeding on the basis that if the

¹⁹ CI 16.10 of the Dexus Agreement.

administration of Citius ends because of a resolution or order for Citius to be wound up, the stay period described in s 451E(1) of the Corporations Act comes to an end upon the completion of the winding up of Citius. The Administrator also sought an order in similar terms pursuant to s 451E(3)(a) of the Corporations Act.²⁰ In doing so, the Administrator, in effect, sought clarification as to how s451E of the Corporations Act operates in the external administration of Citius. The Administrator submitted that he sought the orders to “provide certainty”, in circumstances where there had not previously been judicial consideration of s451E.²¹

Decision by Justice O’Bryan

34. Justice O’Bryan considered the scope of the ipso facto stay in the context of voluntary administration. His Honour held that:

- a. The stay under section 451E does not apply to contractual rights that may arise by reason of the winding up.²²
- b. If the counterparty has a right to terminate a contract by reason of the company’s entry into liquidation, section 451E does not operate to stay that right.²³
- c. The stay only applies to a right that arises by reason of the company entering administration or the company’s financial position during administration. It is the stay of such a right that continues during a subsequent liquidation. The section does not stay the exercise of a right that arises by reason of liquidation.²⁴

Judicial guidance as to the ipso facto stay provisions in voluntary administrations

35. In *Re Citius Property*, the Federal Court was not called upon to decide particularly complex issues, however, the judgment of Justice O’Bryan in *Re Citius Property* does

²⁰ *Rathner, Re Citius Property Pty Ltd (Administrator Appointed)* [2023] FCA 2 at [55] (***Re Citius Property***).

²¹ *Re Citius Property* at [56].

²² *Re Citius Property* at [60].

²³ *Re Citius Property* at [60].

²⁴ *Re Citius Property* at [60].

at least confirm that the stay provisions in relation to voluntary administration apply as the plain words of the stay provisions in the Corporations Act suggest.

36. Further, the judgment reinforces the position that the stay provisions are not triggered upon the winding up of a company. Therefore, ipso facto clauses potentially still have work to do if those drafting them ensure they are triggered by liquidation rather than voluntary administration.

Further thoughts on the ipso facto stay provisions

37. We have to wait further for judicial guidance as to what is required for a Court to order that the ipso facto stay be lifted.
38. The stay provisions are overly complicated and subject to so many specific exceptions and carve-outs that draw artificial and arbitrary distinctions between common forms of commercial transactions, with the result that creditors with similar transactions may have very different contractual rights during a restructuring effort.
39. Contracts must be carefully reviewed to determine not only whether they fit within a class wide contract type exclusion (as covered by the Regulations). It remains to be seen whether some creditors will attempt to circumvent the stay by taking advantage of the vast range of exclusions in the legislative provisions.

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