ENHANCING THE EXISTING INSOLVENCY LEGAL FRAMEWORK – IPSO FACTO CLAUSES

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On 10 September 2018, the Insolvency, Restructuring, and Dissolution Bill ("the proposed Omnibus Bill") was submitted by the Ministry of Law for First Reading in Parliament.
The proposed Omnibus Bill caps the 3 phased approaches to reform and strengthens Singapore's debt restructuring ecosystem, implementing recommendations from reports from earlier Insolvency Law Reviews and Committee Reports as well as industry feedback. The earlier 2 phases have involved amendments to the Bankruptcy Act and Companies Act in July 2015 and March 2017 respectively.

The main objectives of the proposed Omnibus Bill are to:

1. Consolidate the personal and corporate insolvency and restructuring legal framework into a single piece of legislation;
2. To enhance existing insolvency and restructuring laws; and
3. To establish a regulatory regime for insolvency practitioners.

This short note seeks to focus on the potential impact of the new Omnibus Bill on ipso facto clauses which are commonly found in many commercial contracts.

Enhancing the existing insolvency legal framework – ipso facto clauses

A notable development in the proposed Omnibus Bill is the introduction of restrictions on the enforcement of ipso facto clauses in commercial contracts. These ipso facto clauses entitle a party to unilaterally terminate or modify the contract upon the occurrence of a specified trigger event, such as an insolvency-related or restructuring event. Presently, the use of such clauses is unrestricted, which poses difficulties for companies that are restructuring as they allow contractual counterparties to "pull the rug from underneath their feet" by disrupting the businesses' contractual arrangements that may be material. By reducing the scope for a successful restructuring, other creditors may be potentially prejudiced and potential "white-knight" rescue investors may similarly be deterred. These may render restructuring efforts nugatory.

This proposed restriction on enforcement of ipso facto clauses was previously considered in detail by the Insolvency Law Review Committee in 2013, who ultimately declined to accept them. It is worth noting that this new approach is in line with that taken by Australia recently and being proposed currently in the United Kingdom.

Australia

In Australia, the new ipso facto regime (which was enacted in September 2017, and came into effect on 1 July 2018) was introduced by amending part 5.1 of the Corporations Act 2001. Under this new regime, unless excluded, a "stay" on the enforcement of ipso facto clauses will apply to all contracts, agreements or arrangements entered into on or after 1 July 2018. The "stay" restricts the ability of contractual counterparties to rely on ipso facto clauses to terminate or exercise other contractual rights under affected contracts, when they are triggered by the entry of a company into or commencing voluntary administration, receivership or a scheme of arrangement. Courts are also empowered to prevent a party from terminating a contract for a purportedly unrelated reason if it appears that the termination relates to the occurrence of an insolvency event.

Parties cannot contract out of the new ipso facto amendments and any newly created contractual rights that are in substance contrary to the ipso facto amendments will not be enforceable. However, the stay will not prevent the enforceability of most other rights against "insolvent" companies for reasons unrelated to the financial condition or insolvency – such as non-payment or non-performance of any contractual obligations.

The ambit of the new regime is also tapered by two categories of exceptions:

1. ***excluded types of contract:*** these are contained in the amended Corporations Regulations 2001. They include, but are not limited to the following:
    1. supply contracts with the government;
    2. certain derivative and securities financing contracts;
    3. certain contracts involving special purpose vehicles;

4. certain construction contracts; and
5. contracts for the safekeeping of codes or passwords in escrow.

These excluded types of contracts and all rights under them are exempt from the operation of the ipso facto stay.

2. ***excluded types of contractual rights:*** these are contained in the Corporations Amendment (Stay on Enforcing Certain Rights) Declaration 2018. These contractual rights include They include, but are not limited to the following:
    1. rights under a financing arrangement, or guarantee, indemnity or security related to a financing arrangement, to change the basis of calculation of an amount (such as default interest);
    2. rights to indemnities for costs, liabilities, and loss incurred when preserving or enforcing rights;
    3. rights to change the priority, or order, in which amounts are to be paid, distributed or received;
    4. rights of set-off, rights of a combination of accounts and rights to net balances; and
    5. rights to assign or novate rights or obligations.

United Kingdom

In the UK, in its latest response on consultation on insolvency law reform on 26 August 2018, the government has indicated that it will legislate to prohibit the enforcement of ipso facto clauses by a supplier in contracts for the supply of goods and services on the ground that one of the parties to the contract has entered formal insolvency. However, full details of the proposals are not available at the moment.

Singapore

In Singapore, Section 440 of the proposed Omnibus Bill restricts the enforcement of ipso facto clauses once any proceedings relating to any applications under Judicial Management and Scheme of Arrangement are commenced by a company.

However, a list of contracts is expressly excluded from the restrictions. These include: (i) any prescribed eligible financial contract, (ii) any contract that is a license, permit or approval issued by the government or a statutory body, (iii) any commercial charter of a ship; and (iv) any agreement that is the subject of a prescribed treaty to which Singapore is a party. Compared to the Australian regime the types of excluded contracts envisaged in the proposed framework in Singapore at this stage seems narrower as apart from the specific types of the contract mentioned the category of contracts to be prescribed under regulations seems limited to “eligible financial contracts”.

Further, similar to Australia, under Section 440(2)(b), although contracts will remain on foot, a counterparty is not required to continue to advance new money or credit to an insolvent company. Finally, Section 440(4) provides Singapore courts with an overriding power to rule on the applicability of the restrictions and their extent if the applicant can demonstrate that it will suffer “significant financial hardship” as a result.

Conclusion

The Insolvency, Restructuring and Dissolution Bill and its relevant regulations usher in yet another major reform to the insolvency and restructuring system in Singapore and will undoubtedly be keenly watched by insolvency practitioners and interested parties in the coming months.

In particular, commercial parties should be cognisant that any agreements and contractual documentation that will come into effect after the passage of the Omnibus Bill may need to be reviewed in light of the amendments.

As the Ministry of Law notes, the new provisions "will benefit local businesses experiencing financial difficulties, position Singapore as a location of choice for foreign debtors to restructure; and create new opportunities for insolvency professionals (including lawyers and accountants), distressed debt funds and financial institutions".