

## Legal Update

### Impact of the Insolvency, Restructuring and Dissolution Act 2018 on Contractual Clauses

24 March 2021

The Insolvency, Restructuring and Dissolution Act 2018 (No. 40 of 2018) ("**IRDA**") which aims to consolidate Singapore's corporate and personal insolvency and restructuring laws, came into force on 30 July 2020.

Of particular interest to commercial parties is the introduction of the restrictions on *ipso facto* clauses, which are often contained in commercial agreements to allow a party to unilaterally terminate the agreement or exercise certain remedies usually if the counterparty becomes insolvent or commences insolvency proceedings. Previously, there were no restrictions on the exercise of *ipso facto* clause under Singapore law.

In this legal update, we examine the scope and impact of the restrictions placed on *ipso facto* clauses under the IRDA and discuss how commercial parties may address the insolvency risks of counterparties going forward.



#### IpsO Facto Clauses

*IpsO facto* clauses provide a degree of protection from counterparty insolvency risk by giving the non-insolvent party the right to terminate all contractual relations with the insolvent counterparty when it becomes uncertain that the counterparty can fulfil its contractual obligations. For instance, *ipso facto* clauses are especially important in facility or loan agreements as it gives the lender the right to demand immediate repayment of and/or to prematurely terminate, a loan facility upon the insolvency of the borrower. An example of an *ipso facto* clause is as follows:

*"This Agreement shall terminate, without notice, (a) upon the commencement by or against, either party of insolvency, receivership or bankruptcy proceedings or any other proceedings for the settlement of either party's debts, (b) upon either party making an assignment for the benefit of creditors, or (c) upon either party's dissolution or ceasing to do business."*

However, *ipso facto* clauses hinder the rehabilitation efforts of companies in financial distress. It gives its key suppliers, service providers and financiers the right to unilaterally terminate contracts and demand immediate payment. This creates a lot of uncertainty in whether the company may continue with its day-to-day operations and its cashflow issues are exacerbated when payment terms are accelerated.



#### Restriction of IpsO Facto Clauses Under Section 440 of the IRDA

The IRDA introduced restrictions on the operation of *ipso facto* clauses while a company is undergoing restructuring proceedings to support the restructuring efforts of companies in financial distress. It was introduced as part of Singapore's ongoing efforts in establishing itself as an international debt restructuring hub and to align Singapore's restructuring regime with jurisdictions such as the US and Canada.

Section 440(1) of the IRDA provides that no person may, during any proceedings relating to any court approved compromise, arrangement, or judicial management<sup>1</sup> ("**Proceedings**"), by reason only that the Proceedings are commenced or that the company is insolvent,

<sup>1</sup> Section 440(6) of the IDRA provides that proceedings means any proceedings arising from:

(a) any application under section 210(1) of the Companies Act for the approval of the Court in relation to any compromise or arrangement between a company and its creditors or any class of those creditors;  
 (b) any application under section 71 of the IRDA for the approval of the Court in relation to any compromise or arrangement;  
 (c) any application for an order under section 64 or 65 of the IRDA;  
 (d) any application for a judicial management order under section 91 of the IRDA; or

- (a) terminate or amend any agreement with such company,
  - (b) claim an accelerated payment or forfeiture of the term under any agreement with such company<sup>2</sup>; or
  - (c) terminate or modify any right or obligation under any agreement with such company,<sup>3</sup>
- (the "**IpsO Facto Restrictions**").

The IpsO Facto Restrictions shall only apply to contracts entered into on or after 30 July 2020. The IpsO Facto Restrictions do not:

- (a) prohibit a party from requiring payments to be made in cash for goods, services, use of leased property or other valuable consideration provided after the commencement of the Proceedings; or
- (b) require the further advance of money or credit<sup>4</sup>.

It is worth noting that the Proceedings are restricted to restructuring proceedings, being schemes of arrangement or judicial management proceedings<sup>5</sup>. The IpsO Facto Restrictions do not apply if the counterparty undergoes other insolvency processes such as winding up or receivership. Further, the IpsO Facto Restrictions do not apply to ipso facto clauses that are triggered on any other contractually provided grounds such as a failure to perform an obligation under the contract.

The IpsO Facto Restrictions may not be contracted out of. Any provision in a contract that has the effect of providing for, or permitting, anything that, in substance is contrary to the restrictions under section 440(1) of the IRDA shall be of no force or effect<sup>6</sup>.



## Exceptions

### Prescribed Exceptions

Certain specified classes of agreements are exempt from the IpsO Facto Restrictions<sup>7</sup>, which include among others, any prescribed financial contracts ("**Prescribed Financial Contracts**"), government contracts<sup>8</sup> and charter contracts. Certain corporate entities are also exempt from the IpsO Facto Restrictions.

#### *Prescribed Financial Contracts*

The list of Prescribed Financial Contracts is set out in the Insolvency, Restructuring and Dissolution (Prescribed Contracts under Section 440) Regulations 2020, which includes derivatives, contracts which are not dependent on the existence/provision of a netting or set-off arrangement, debentures (including bonds and perpetual securities), covered bonds, financial contracts creating a security interest or a credit support arrangement in connection with the foregoing<sup>9</sup>.

#### *Excluded Entities*

The Insolvency, Restructuring and Dissolution (Prescribed Companies Under Section 440) Order 2020 provides that a covered bond special purpose vehicle and a securitisation special purpose vehicle (as defined in the Insolvency, Restructuring and Dissolution (Prescribed Companies and Entities) Order

(e) the lodgment of a written notice of the appointment of an interim judicial manager under section 94(5)(a) of the IRDA.

<sup>2</sup> Including a security agreement.

<sup>3</sup> Including a security agreement.

<sup>4</sup> Section 440(2) of the IRDA.

<sup>5</sup> Section 440(6) of the IRDA.

<sup>6</sup> Section 440(3) of the IRDA.

<sup>7</sup> Section 440(5) of the IRDA.

<sup>8</sup> Contracts with the government or a public body or the Monetary Authority of Singapore (the "**Authority**") that are essential for the government, public body or the Authority (as the case may be) to carry out its function or for the provision of essential services are excluded from the IpsO Facto Restrictions.

<sup>9</sup> Section 3 of the Insolvency, Restructuring and Dissolution (Prescribed Contracts under Section 440) Regulations 2020.

2020) are excluded from the operations of the Ipso Facto Restrictions. The rationale for such exclusion being that the legislative intent of section 440 of the IRDA is to facilitate the revival of a distressed operating business and will not be relevant for a special purpose vehicle involved in a securitisation transaction which in its nature, does not carry on an operating business.

### Significant Financial Hardship

Section 440 of the IRDA allows a party to apply to the court from an exemption from the application of the Ipso Facto Restrictions on the ground that the operation of the Ipso Facto Restrictions would likely cause the party significant financial hardship. The burden lies on the party to satisfy the court that that he would likely suffer "significant financial hardship". To date, "significant financial hardship" has not been defined under the IRDA and no case law has been developed.



### What does this mean for you?

Commercial parties which wish to include ipso facto clauses in their contracts should be aware of the Ipso Facto Restrictions and provide for alternative arrangements to protect their interests if a counterparty enters into restructuring proceedings. For instance, parties may provide for the termination of the contract on other substantive grounds, such as non-payment or non-performance by the insolvent company by a stipulated timeline. In this regard, ipso facto clauses which contravenes the Ipso Facto Restrictions should not be included in the contracts.

In addition, section 440 of the IRDA may incentivise companies facing impending financial difficulties to consider applying for restructuring proceedings as a pre-emptive action before the occurrence of a default under their contracts. This would be over and above the moratoriums restraining debt enforcement actions which the company can apply for under the IRDA, when proposing a scheme of arrangement<sup>10</sup> or entering judicial management<sup>11</sup>.

Please do not hesitate to contact our team if you have any further queries.

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<sup>10</sup> Section 66 of the IRDA.

<sup>11</sup> Section 95 of the IRDA.

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