

Member Update

UPDATE 12 of 18 • 29 May 2018

TOPIC: IMPACT OF CHANGES TO INSOLVENCY / IPSO FACTO LAWS

DISTRIBUTION: GTA Members – primary contact list. Please circulate to all appropriate internal parties.

1. PURPOSE:

The purpose of this update is to raise awareness and inform GTA Members of pending changes to Australian insolvency laws.

IMPACT OF CHANGES TO THE AUSTRALIAN CORPORATIONS ACT ON INSOLVENCY CLAUSES

2. BACKGROUND

A contract counterparty's solvency is fundamental to the trading of grain. Accordingly, it is common for grain contracts to contain an "insolvency clause" or "ipso facto clause" which allows a party to terminate a contract in the event of an act of insolvency by a counterparty.

However, GTA members should be aware that under the new provisions of the *Corporations Act 2001* (Cth) (**the Act**) due to take effect from 1 July 2018 (**the Amendments**), the operation of ipso facto clauses will be suspended (or "stayed") under certain circumstances.

The rationale behind the Amendments is that ipso facto clauses can tend to accelerate the demise of a company and hinder the ability of an external administrator to restructure a business. For example, if a company has profitable contracts when an administrator is appointed, under existing ipso facto clauses those contracts may be terminated, destroying any value which may remain in an insolvent business.

Being conscious that the Amendments may impact the grain industry and GTA members, GTA has sought legal advice from Holding Redlich to better understand the impact of the Amendments and to ascertain what changes may be required (if any) to the Trade Rules and/or Standard Form Contracts to provide some protection to GTA Members – consistent with GTA's mission to facilitate trade.

Whilst detailed recommendations on the appropriate amendments to the Trade Rules in response to the Amendments is still under consideration, our current advice notes the following:

1. Under the Amendments, counterparties to a contract may be unable to rely on ipso facto clauses that terminate or modify a contract solely because a company enters into a scheme of arrangement or voluntary administration.
2. With a few exceptions, such as business sale agreements, agreements involving a special purpose vehicles and agreements relating to various types of financial products, the Amendments mandate an automatic stay on a party's rights to enforce a provision to terminate or amend a contract solely because the counterparty enters into voluntary administration or a scheme of arrangement. However, it is important to note that the:

- a) stay does not apply to liquidations or the appointment of a receiver or other controller appointments that are not over the whole or substantially the whole of a company's property;
 - b) stay will only operate while the administration or scheme of arrangement is ongoing, and ceases when a party is in liquidation; and
 - c) the Amendments only relate to agreements entered into after 1 July 2018.
3. Despite the operation of a stay, a counterparty will generally still maintain any other (non-*ipso facto*) rights to terminate or amend a contract, including for breach of non-payment or non-performance. However, the Amendments give power to the court to order that certain rights under a contract can only be enforced with the leave (i.e. approval) of the court and subject to conditions imposed by the court if it is satisfied that a party is enforcing, threatening to enforce, or is likely to enforce the contractual right merely because its counterparty entered into administration or a scheme of arrangement.

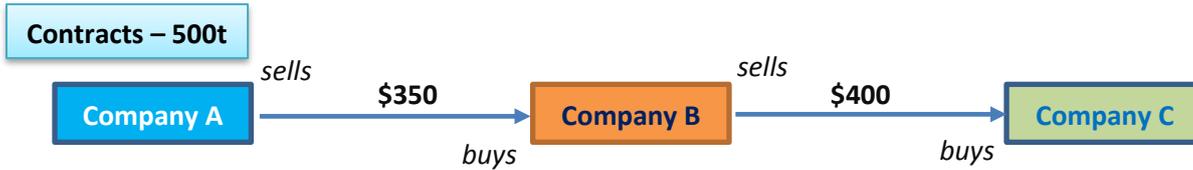
3. When is the 'stay' on insolvency/*ipso facto* clauses unenforceable?

The Amendments to the Act make contractual rights unenforceable (ie, there is a "stay" on enforcement) if any of the following types of external administration occur:

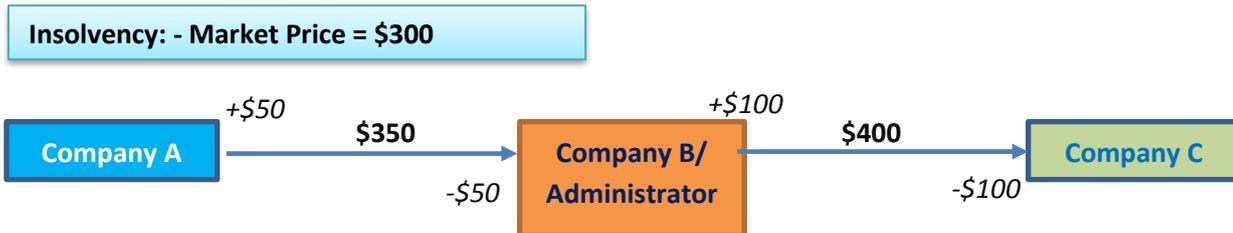
INSOLVENCY EVENT	WHAT IS IT?	WHEN WILL CONTRACTUAL RIGHTS NOT BE ENFORCEABLE?
Scheme of Arrangement	A statutory mechanism by which a company can enter into a compromise or arrangement with its members or creditors	A "body" publicly announces that it will/has applied and enters into a scheme of arrangement (but only where the company's application to commence the scheme states that it is being made to avoid being wound up in insolvency)
Receivership	A receiver is appointed to a company by a secured creditor. The receiver's role is to take control of the secured assets to ensure payment of debts owed by the company to the secured creditor	A receiver or other managing controller of the whole or substantially the whole of a "corporation's" property is appointed or exists
Administration	A company elects to appoint an administrator. The administrator's role is to investigate the company's affairs and assess its viability to continue as a going concern	A "company" enters into voluntary administration

4. How is this likely to operate in a grains context?

Assume the following scenario:



- Company A has sold 500mt of a specific grade of grain to Company B at \$350/mt for June delivery, payment 30 days from end of month of delivery.
- Company B has sold 500mt of the same grain to Company C for \$400/ mt also for June delivery with the same payment terms.
- Before delivery, Company B appoints an Administrator and at the same time, the market price for this grain for the June delivery period is \$300/mt.
- Upon appointment of the Administrator, Company B has 500mt of the same grade of grain in inventory.
- Assume both contracts contain a clause which stipulates that the contracts automatically end on an event of insolvency.



Scenario – Current Law:

- Under the Act as it currently stands, both contracts can end, and the Administrator is left holding 500mt of grain worth \$300/mt.
- While an Administrator may wish to make the delivery to Company C at the contract price of \$400/ mt, one would assume that Company C would rather terminate the contract based on the ipso facto clause and will simply buy the grain at the current market price of \$300/ mt, saving it \$100 /mt.

Scenario – IPSO Facto Amendments:

- Under the Amendments, both contracts remain alive or active.
- However, a situation arises where the Administrator could determine that with the market price (\$300/ mt) below its purchase contract price with Company A (\$350/ mt) and with stock in inventory (valued at \$300/ mt), Company B's best interests would be served by:
 - Not executing the purchase contract with Company A (saving it \$50/ mt)
 - But still enforce the sales contract (priced at \$400 / mt) against Company C (capturing \$100/ mt).

Further, if there were any problems with the stock delivered to Company C – Company C would have to seek leave of the Court to commence proceedings against Company B in administration, or otherwise be left standing in the queue of unsecured creditors.

Jurisdiction issues for Exporters attention:

Another issue which may arise is jurisdiction. In the example above, assume that Company C is in another country and the contract between Company B and Company C is governed by English law and subject to arbitration in London. It is unlikely that the Administrator would be able to enforce the contract against Company C and most unlikely that arbitrators in London would consider Australian insolvency law as prevailing over the parties' choice of English law."

5. Conclusions and Actions

Given the Amendments have not yet commenced, it is difficult for GTA to provide its Members with clear guidance or clarity as to what will be the effect of the laws.

However, what is clear at this stage is that GTA members should be aware that the impending changes will be mean a contract cannot be terminated due to a counterparty having an administrator appointed or being subject to a scheme of arrangement.

In response to the Amendments, we are seeking further advice on whether any changes are required to GTA's Contracts and Trade Rules to ensure that any right currently activated by an insolvency event or the financial position of a counterparty remain available and GTA will provide Members with further information as it becomes available.

6. Further Details

Visit the GTA website for full details. <http://www.graintrade.org.au/membership>