# LEGAL ANALYSES

# Ipso Facto Clauses and their Position in Financing Documents in Singapore

**Emmanuel Hadjidakis***

**Kunal Katre****

Contract terms; Financial services; Singapore; Variation clauses

## Abstract

*This legal analysis examines developing market practice in the Singapore legal market on the contractual treatment of the restriction on ipso facto clauses. This legal analysis discusses the relevant legislation that restricts the operation of such ipso facto clauses and the different approaches that parties to a financing transaction may take when tackling this issue.*

With the coming into force of the Insolvency, Restructuring and Dissolution Act 2018 (IRDA) on 30 July 2020, the contractual treatment of the restriction on ipso facto clauses imposed by s.440 of the IRDA has come into sharp focus on financing transactions in the Singapore market. In general terms, an ipso facto clause is a contractual provision that allows one party to the contract to terminate or modify the operation of the contract upon the occurrence of certain specified events (e.g. insolvency, appointment of an administrator, receiver or liquidator) in respect of another party.

Section 440 of the IRDA effectively imposes a stay on the use of ipso facto clauses and thereby prevents parties (such as lenders) from enforcing their rights against counterparties (e.g. borrowers) where the lenders are seeking to do so solely by reason of an insolvency or insolvency related event impacting the borrower. *It is important to bear in mind that the stay on the use of ipso facto clauses would not prevent lenders taking action against a borrower for other events of default (unlinked to insolvency events)*, so for example, if the borrower is in payment default, or in breach of any other obligations that it owes to the lenders, the stay on the use of ipso facto clauses would not restrict a lender's right to accelerate the loans against the borrower in relation to those defaults.

From a practical perspective, if a borrower is insolvent or is subject to insolvency proceedings (whether voluntary or otherwise), it is quite likely that there are other events of defaults which would be triggered in a typical loan agreement with a full covenant package. However, as a result of the restriction on the operation of ipso facto clauses pursuant to the IRDA, lenders will now need to consider what modifications may need to be made to third-party guarantees and security documents where the guarantee and security providers are themselves not affected by the relevant insolvency regime and do not benefit from the protection from the operation of the ipso facto clauses.

In markets such as Australia where similar restrictions on ipso facto clauses have been in place since 2018, the finance documents have evolved to include "ipso facto triggers" in guarantees and security documents which are aimed at assisting lenders to essentially "accelerate" the loan against guarantors so that the guarantors can be required to pay the full amount of the loan despite the stay on enforcement at the borrower level. *As described above, it should be noted though that where a guarantor or security provider is itself affected by a relevant insolvency regime and hence enjoys the benefit of the protection from an operation of the ipso facto causes, lenders may be stayed under the ipso facto provisions from enforcing this right against such guarantors or security providers*.

As the IRDA is still a relatively new legislation, market practice in Singapore with respect to inclusion of ipso facto triggers in finance documents is still very much evolving and this evolution is likely to take different forms in the financing documents, depending on, among other things, the nature of the deal, the structure of the transaction, the jurisdictions involved and the parties negotiating the documents.

On a "typical" middle-of-the-road corporate finance deal, the restriction on the operation of ipso facto clauses is likely to be less relevant as the security documents for such transactions usually provide for an enforcement trigger that is linked to an event of default as opposed to an acceleration event against the borrower. This is because the insolvency event would still qualify as an event of default (albeit the lenders may be restricted from accelerating the debt) which would mean that the security enforcement trigger in the third-party security documents has been met. Now absent an acceleration one might

* Principal, Baker McKenzie Wong & Leow.
** Local Principal, Baker McKenzie Wong & Leow.

query what practical benefits an "enforcement" of security is likely to have, but there are certain benefits to this (particularly where security is held through a security trust), in situations where:

- there is more than a reasonable likelihood of insolvency ultimately affecting the security providers; and
- the assets are fairly liquid and easy to enforce against and realise their value.

In situations as those described above, there may be practical merit for a security trustee to enforce the secured assets and hold enforcement proceeds on trust for the creditors (so they are protected from any insolvency of the security provider), and which proceeds can then be applied towards satisfaction of the secured liabilities as and when an acceleration is possible.

We can contrast the above with the sponsor-styled financing transactions which are more borrower-friendly and where enforcement triggers with respect to security documents are linked to actual acceleration and not simply the continuation of an event of default. It is in these transactions that the restriction on the operation of ipso facto clauses becomes quite relevant in the context of third-party security arrangements. The key documentation point on these transactions which the new IRDA legislation is throwing up is whether, in the third-party security documents entered into by security providers that do not benefit from the protection from the operation of the ipso facto clauses, the enforcement trigger should be modified to provide for an "ipso facto trigger", similar to what has developed in other jurisdictions like Australia.

There is no easy answer to this question and an adviser's view may vary depending on which hat he or she is wearing at the time, as arguments can be made on both sides. For example, if one is acting for the sponsors, one can argue that if a legislation is offering a borrower specific protection against acceleration, then the benefit of that protection, by implication, should extend to the entire structure. Simply put, if a lender is not entitled to accelerate a loan under the facility agreement, there should not be a separate trigger that somehow allows the lender to go around that provision and have the ability to enforce on third-party security without actually being able to accelerate the loan in the first place. It can be said that such argument, from the sponsor's point of view, seems like a fair and reasonable argument to make.

Switching sides briefly, a lender's adviser can argue that if it is still legally permissible for a lender to be able to enforce against a security provider through an ipso factor enforcement trigger being built into the documents, the lenders should have that option available to them as such enforcement may (in theory) be of some benefit to the lenders as seen in the situations discussed above. Another argument that could be made on this side of the fence is that a borrower may potentially apply for insolvency proceedings with a view to seek the benefit of the protection from ipso facto clauses and such action could effectively create a stay on enforcement across all of the security and as the lenders cannot control this, the documents should provide them with the enforcement option by way of an ipso factor trigger.

In conclusion, as seen from the two perspectives above, equally compelling arguments on this issue from both sides can be made, and over the coming months as more and more deals in Singapore will grapple with this issue, we expect to see a trend forming in the market on this issue around the inclusion (or exclusion) of such ipso factor triggers. As history has shown in the past and continues to do so regularly, market practice on documentation is ever evolving given the impact of new legislation, legal issues, different structures and adoption of practices from other jurisdictions, to name a few factors. With the coming into force of the IRDA, the debate on ipso facto triggers and ipso facto clauses in financing documentation in the Singapore market is likely to continue for a few months and we will certainly be at the forefront of some of those debates to shape the course of the financing documentation over this next exciting phase.