



The restriction on the exercise of 'Ipso Facto' rights – What does it mean for the construction industry?

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EDIT: The Minister for Revenue and Financial Services has now issued an explanatory statement as well as a draft declaration and draft regulations which outline various rights and agreements which are proposed to be exempted from the 'ipso facto' amendments to the Corporations Act 2001 (Cth) discussed in this article. While the proposed exemptions mainly relate to financing agreements, some would apply to the construction industry, such the proposed exemption of:

- Agreements to which a special purpose vehicle is a party;
- A right to set-off;
- A right to perform the obligations of the financially precarious party which will include a developer's or contractor's right to step in and take over the works; and
- A right to transfer, assign or novate obligations under the relevant agreement.

The proposed exemptions would lessen the impact the 'ipso facto' restrictions would have otherwise had on the construction industry and, if adopted, may well see an increase in the use of special purpose vehicles by principals and developers.

It's 30 January 2019. Todd is a developer. Todd's company is developing a medium sized apartment complex. It's Todd's first major development. He has invested a lot of time, money and energy in getting the project off the ground. Todd used the standard form AS4902-2000 design and construct contract when he engaged his builder. All Todd's work is starting to pay off; the build is coming along well. But then Todd starts to hear whispers that his builder isn't paying its subbies. The next thing he knows, the QBCC has cancelled the builder's licence and the next day the builder appoints external administrators.

Todd is disappointed, but thinks to himself, "It's ok, because the contract says I can terminate if the builder appoints an administrator. I will just do that and step in and appoint another builder". Todd speaks to his lawyer, who tells him that he can't terminate the contract and step in and take over the work because of changes the Commonwealth government has recently made to the Corporations Act 2001 (Cth) ("Act").

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Unfortunately, insolvencies are not an uncommon occurrence in the construction industry. Historically, while developers or larger contractors who have had their builders or subcontractors encounter financial difficulties mid-project had a mess to clean up; they also commonly had various contractual protections available to them to limit the damage. But has the Commonwealth government taken away those contractual protections?

Last year, the Commonwealth government introduced amendments to the Act which are intended to provide companies with greater opportunity to restructure or trade through financial difficulties when they may have otherwise entered into liquidation. This is intended to be achieved through two mechanisms: the first is safe

harbour, and the second is by limiting contracting parties' ability to make use of their '*ipso facto*' contractual rights when the corporate entity they have contracted with is struggling financially.

'*ipso facto*' means '*by the fact itself*' in Latin. '*ipso facto*' contractual rights are rights which are exercisable as a direct result of a specific event. One common '*ipso facto*' right, which is included in almost all commercial contracts no matter the subject matter, is each party's right to terminate the contract as a consequence of the other party experiencing an insolvency event. The types of insolvency events that trigger a right to terminate can vary, but usually include the appointment of liquidators, external administrators, receivers, managers, controllers, etcetera.

What does this mean for Todd? Unfortunately, even though he has a contractual right to terminate because the builder appointed external administrators, the new changes to the Act prevent him from doing so. Todd will have to ascertain if he has other termination rights under the contract or otherwise seek and obtain the external administrators' consent for Todd to terminate the contract (which may not be forthcoming or may come with strings). If Todd cannot find a way to lawfully terminate the contract or the external administrators are unhelpful, he will be in a tight spot.

Luckily for Todd, he is able to negotiate an agreed termination with the external administrators on terms he can live with. Given his experience, Todd engages a specialist building and construction lawyer to prepare the contract he will enter into with the new builder to complete the project. The new contract contains a number of clauses which are designed to help Todd terminate the new contract lawfully if he is unlucky enough to find himself in the same situation.

While we have spoken about Todd's circumstances in this article, the restrictions upon the use of '*ipso facto*' rights

will affect everyone in the construction industry no matter where you sit within the contractual chain. What are the amendments that can be made to your contracts to provide you with better protection? To a large extent it will depend on your position in the contractual chain and the specifics of the project at hand, but some examples are ensuring your rights to terminate for delay, payment issues and licencing issues are well defined and enforceable. These rights will be key to ensuring the '*ipso facto*' restrictions do not unduly affect you once they come into operation on 1 July 2018.

If you are a construction industry participant and want to protect yourself as much as possible against third party insolvencies, please contact Nerida Whelan at n.whelan@clarkekann.com.au or 07 3001 9252.

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