

The promise and perils of regulating *ipso facto* clauses

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Abstract

It is common for contracts to include a clause that provides that on an event of default the counterparty has an unconditional right to terminate the contract or accelerate payment (an *ipso facto* clause). The regulation of *ipso facto* clauses has become a topic of debate in recent years with a number of jurisdictions introducing constraints on such clauses as part of broader restructuring reform packages. These jurisdictions include Germany in 2021 (as part of its implementation of the EU Restructuring Directive) and the United Kingdom in 2020. For jurisdictions introducing such constraints for the first time, there is much to learn from those, such as Canada, that have had constraints on *ipso facto* clauses in place for much longer. This article examines the experience in Canada alongside the constraints introduced in the United Kingdom, the EU Restructuring Directive and Germany, and identifies a series of steps that policymakers should follow when revising a regime on *ipso facto* clauses. Although there are a number of common themes that emerge, it is clear that different jurisdictions often make quite distinct policy choices regarding the rationale for any constraints on *ipso facto* clauses as well as on the specific nature and scope of the provisions. Different jurisdictions find different points of balance between the interests of individual creditors in upholding their freedom of contract and the rights of the

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debtor and creditors as a whole in preserving the business as a going concern. The range of choices is not per se problematic as long as they are implemented with clarity and transparency, so that debtors and creditors can bargain *ex ante* in the light of any legislative provisions.

1 | INTRODUCTION

Many jurisdictions have made changes to their debt restructuring regimes in recent years to provide financially distressed but viable businesses with the means to restructure their business and avoid liquidation. These amendments were initially prompted by the aftermath of the 2008 global financial crisis, but more recently the financial problems caused by the COVID-19 pandemic have demonstrated how important it is for jurisdictions to have effective mechanisms to deal with these issues. These reform packages bear a remarkable similarity in their core components, which invariably include the possibility of cross-class cramdown, a restructuring moratorium and *ipso facto* provisions, even though the details differ. Commonly, these debt reform packages have looked to other regimes that have already integrated these measures, such as US Chapter 11 and the Canadian regime, for inspiration in formulating and shaping these reforms.

This article examines one aspect of these reform packages, namely, the introduction of measures to regulate *ipso facto* clauses. Specifically, it considers the *ipso facto* reforms introduced in the United Kingdom in the Corporate Insolvency and Governance Act 2020 as part of a broader package of reforms of restructuring and insolvency law in response to the COVID-19 pandemic, and the *ipso facto* reforms introduced in Germany in 2021 as part of its implementation of the EU Restructuring Directive.¹ For those jurisdictions introducing constraints on the enforceability of *ipso facto* clauses for the first time, there is much to learn from jurisdictions that have experience operating a ban on *ipso facto* clauses. This article examines the Canadian experience, both in terms of the choices made and the way in which those choices have operated in practice, as a means of casting light on the nascent United Kingdom and European *ipso facto* regimes.

1.1 | What is an *ipso facto* clause?

Many contracts include a clause that states that on an event of default, the counterparty has an unconditional right of termination of the contract or acceleration of payment, sometimes referred to as *ipso facto* clauses.² The words *ipso facto* literally mean ‘by the fact itself’ and in contract law mean ‘by the mere effect of an act or a fact’.³ Hence, by the fact of being insolvent, or an insolvency proceeding commencing, the termination and/or acceleration clause is activated. Events of default can include making an application for commencement of insolvency proceedings by the debtor or creditors; the appointment of an insolvency representative; the fact that the debtor satisfies the criteria for commencement of insolvency proceedings; and in some cases, a debtor being in financial distress and failing to meet its obligations under the contract.⁴

An *ipso facto* clause allows the counterparty to terminate or amend the contract or to demand an accelerated payment in the event that the other party is in default or on the occurrence of other events specified in the contract. Such clauses clearly set out the reasons that the

creditor can demand loan repayment, providing some protection to lenders who extend financing to businesses. The *ipso facto* clause offers an automatic remedy for the creditor without the time and expense of judicial enforcement proceedings as the creditor can demand accelerated payments or terminate the contract, thus saving transaction costs associated with default.

1.2 | A ban on enforceability of *ipso facto* clauses solely by reason of insolvency or commencing insolvency proceedings

Deciding whether and how to implement a ban on enforceability of *ipso facto* clauses can raise difficult policy choices for jurisdictions. Fundamental questions about the appropriate balance between creditors' and debtors' interests, and between creditors *inter se*, are raised. Jurisdictions need to make choices about the extent to which they will uphold the freedom of contract of individual creditors, or constrain those rights for the benefit of broader policy goals. Even once the decision to implement a ban is taken, difficult choices need to be made about the breadth of the provision, for example, whether some creditors may be exempted, and if so, which ones, and the extent to which compensation or protection may be offered to affected parties. The choices made by jurisdictions are likely to depend on a number of factors, including the extent to which the jurisdiction is creditor-friendly or debtor-friendly, regulatory competition issues, and macro-economic conditions.

The structure of this article is as follows: in Section 2, the Canadian experience of implementing an *ipso facto* ban is analysed; in Sections 3 and 4, the United Kingdom and German experiences are discussed together with recent EU legislative developments (Section 5); in light of this material, Section 6 deduces underlying principles and policy choices informing a statutory ban of *ipso facto* clauses, while Section 7 concludes with some general observations that might benefit other jurisdictions that may consider implementing partial or complete bans on enforcement of *ipso facto* clauses.

There are several observations that will become apparent as we examine each jurisdiction. First, in making a decision to limit the effectiveness or enforceability of *ipso facto clauses* during insolvency proceedings, it is important to be very clear on the underlying rationale for interfering with parties' freedom to contract, including consideration of the express goals of any provisions rendering these clauses unenforceable, such as to advance restructuring and/or going concern liquidation, and the balance between debtors' and creditors' individual and collective interests.

Second, there are a number of policy choices to be made even after a decision has been taken to limit the enforceability of *ipso facto* clauses, including the scope of the unenforceability by type of contract, the creation of safeguards for creditors affected, and exemptions of particular kinds of financial or other contracts for broader public policy reasons; the precise moment that the *ipso facto* clause becomes unenforceable in terms of the debtor being insolvent within the meaning of the legislation and/or the commencement of proceedings or other events. Part of that consideration is any incentive effects created by limiting creditor rights at a specific moment or on occurrence of a specific event, such as commencing a proceeding.

Third, the clarity of the actual provision is critically important to creating certainty, transparency and predictability for contracting parties well before insolvency and then during the proceedings. Finally, there may be implications for certainty in commercial relations if policy choices regarding *ipso facto* clauses in one jurisdiction are radically different from those in another in a cross-border case, requiring careful consideration of how such provisions may interact as well as any impact on cross-border comity and cooperation.

2 | THE CANADIAN EXPERIENCE

2.1 | Legislative history and impetus

Canada's insolvency statutes pursue an array of overarching remedial objectives that reflect the wide-ranging and potentially catastrophic impacts of insolvency.⁵ The objectives of both the Bankruptcy and Insolvency Act (BIA)⁶ and the Companies' Creditors Arrangement Act (CCAA)⁷ include providing for timely, efficient and impartial resolution of a debtor's insolvency; preserving and maximizing the value of a debtor's assets; ensuring fair and equitable treatment of the claims against a debtor; protecting the public interest; and, in the context of a commercial insolvency, balancing the costs and benefits of restructuring or liquidating the company.⁸ The BIA sets out a framework of both bankruptcy liquidation and proposals for restructuring for individual debtors and companies. The CCAA is an insolvency restructuring statute that applies to companies with debts greater than CA\$5 million. Notably, the statutory provisions on *ipso facto* clauses cover insolvency under the CCAA but cover only proposed restructuring for companies under the BIA.⁹

Pursuant to the BIA, the relevant clause regarding *ipso facto* clauses is section 65.1, which is triggered when a debtor files a notice of intention to file a proposal (NOI) or files a proposal pursuant to the BIA to propose a composition, an extension of time, or a scheme of arrangement.¹⁰ It prevents a contract counterparty from enforcing an *ipso facto* clause solely for the reason that the debtor company is insolvent or has commenced proposal proceedings. Section 65.1 was enacted in 1992, with minor amendments in 2005 and 2009, primarily safeguards for eligible financial contracts (EFC).¹¹

Canada's other primary insolvency statute, the CCAA, is aimed at facilitating the restructuring of insolvent companies through a plan of arrangement and/or compromise. It has become the statute of choice for many Canadian insolvency restructurings, given its flexibility. The Supreme Court of Canada (SCC) has held that the CCAA:

has the simultaneous objectives of maximizing creditor recovery, preservation of going-concern value where possible, preservation of jobs and communities affected by the firm's financial distress ... and enhancement of the credit system generally.¹²

In 2009, the CCAA was amended to expressly embed protection against *ipso facto* clauses, aligning with the BIA provisions. The public policy reasons were the same, that *ipso facto* clauses should not be used to defeat the company where it can devise a going-concern restructuring plan that is acceptable to creditors and is approved by the court. Prior to 2009, Canadian courts typically approved prohibitions on enforcement of *ipso facto* clauses in the initial order granting commencement of the CCAA proceedings and setting out the scope of the initial stay order.¹³ Thus, the court used its broad statutory authority to impose stays on *ipso facto* clauses at the commencement of CCAA proceedings without there being express statutory language. The stay prevented contractual counterparties from acting on the insolvency of the debtor company or other contractual breaches caused by the insolvency to terminate contracts or accelerate the repayment of the indebtedness owing by the debtor company when it would interfere with the debtor's ability to restructure its financial affairs.¹⁴ These provisions were also included in the Model Orders that were developed by the court in cooperation with practitioners.

Also of note is that Canada's common law, which allows the court to set aside specific contracts during insolvency, dates back to the 1870s, with judgments affirming the existence of the

common law anti-deprivation rule before federal bankruptcy legislation was enacted.¹⁵ In 2020, the SCC affirmed that the anti-deprivation rule continues to operate in common law, complementary to the Canadian statutory regime.¹⁶ This judgment essentially results in rendering *ipso facto* clauses unenforceable in liquidation proceedings, a policy choice to treat contractual clauses consistently across different types of insolvency proceedings. Thus, after Canada introduced its clauses protecting debtors from *ipso facto* clauses almost three decades ago in the BIA and more recently in the CCAA,¹⁷ the common law rule continues to operate alongside the statutory provisions.

2.2 | Scope of unenforceability of *ipso facto* clauses

The fundamental purpose of the Canadian BIA is to provide for the financial rehabilitation of insolvent persons and to provide for the orderly and fair distribution of the property of a bankrupt among their creditors on a *pari passu* basis.¹⁸ The provisions that render *ipso facto* clauses unenforceable are aimed at both of these objectives.

Section 65.1 of the BIA specifies that if a NOI or a proposal has been filed in respect of an insolvent debtor, no person may terminate or amend any agreement, including a security agreement, with the insolvent person, or claim an accelerated payment, or a forfeiture of the term, under any agreement, including a security agreement, with the insolvent person, by reason only that the debtor is insolvent or a NOI or a proposal has been filed in respect of the debtor.¹⁹ Under Canadian law, the debtor must be insolvent before accessing the provisions, insolvency defined on a balance sheet test or being unable to pay debts as they generally become due test.²⁰ Notably, section 65.1 protection does not apply to bankruptcy or receivership of a company, only NOI and proposals.

The BIA further specifies that in respect of a lease or a licensing agreement, no person may terminate or amend any agreement or claim an accelerated payment, or a forfeiture of the term under the agreement, only by reason that:

the insolvent person has not paid rent or royalties, as the case may be, or other payments of a similar nature, in respect of a period preceding the filing of (i) the notice of intention, if one was filed, or (ii) the proposal, if no notice of intention was filed.²¹

The BIA also prohibits a public utility from discontinuing service to the debtor only by reason that the debtor is insolvent, has filed an NOI or a proposal, or the debtor has not paid for services rendered, or material provided, before the filing of an NOI or proposal.²² The BIA expressly states that any contract provision that permits anything contrary to these protections or in substance contrary to the provisions is of no force or effect.²³

Thus, overall, if a contract, security agreement or other agreement specifies that it can be terminated or payments accelerated because of insolvency and the filing of a proposal or NOI, the provisions of the agreement cannot be enforced until a restructuring proposal is resolved.²⁴ The amendments clarified the scope of protection against the impact of *ipso facto* clauses, and essentially put an end to what was perceived as an abuse of *ipso facto* clauses in Canada, where contracts were cancelled only because of the debtor's insolvency event and not for any other breach in performance of the contract.²⁵ If a proposal is withdrawn, refused by creditors or the court, or is annulled, section 65.1(1) no longer operates to prevent enforceability of the clause.

There are also a series of provisions in the BIA that allow for disclaimer, resiliation or assignment of contracts during proposal and NOI proceedings, with a number of checks and balances in the interests of the co-parties,²⁶ a topic beyond the scope of this article. Unlike the US provisions, these provisions operate quite independently.

While this article addresses only corporate entities, it is important to note that for individual debtor entrepreneurs and partnerships, there are mirror provisions in the BIA to the above-discussed provisions.²⁷ In contrast to incorporated businesses, the provisions for unincorporated businesses apply to both liquidation and restructuring of the business.²⁸ The provisions were enacted after the Canadian Senate Committee studying the legislation concluded that there was an unfairness in the treatment of individual business debtors that were attempting a proposal and those seeking 'bankruptcy fresh start'.²⁹

Effective 2009, the CCAA was amended to mirror the safeguards for suppliers and lessors in the proposal provisions of the BIA. Section 34 of the CCAA specifies that no person may terminate or amend, or claim an accelerated payment or forfeiture of the term under any agreement, including a security agreement, with a debtor company by reason only that the debtor is insolvent or has commenced CCAA proceedings, including lessors and public utilities.³⁰ Thus, other than EFC excluded pursuant to regulation, all suppliers and contract counterparties are included in the stay on enforcement of *ipso facto* clauses. As under the BIA, a lessor may not terminate or amend the lease by reason only that proceedings have commenced under the CCAA, that the company is insolvent or that the company has not paid rent in respect of any period before the commencement of those proceedings.³¹ There are similar protections against public utilities cutting off services.³² Any contractual provisions that have the effect of providing for, or permitting, anything that, in substance, is contrary to section 34 are of no force or effect.³³

2.3 | Safeguards and exemptions

There are several counter-balancing measures to the prohibition on enforceability of *ipso facto* clauses on insolvency in Canada. They take two forms. First is protection of suppliers of goods and services as counterparties to contracts with the debtor, and the second is a series of exemptions from the provisions for particular types of contracts in the financial sector.

2.3.1 | Safeguards

The BIA expressly states that the provisions limiting enforcement of *ipso facto clauses* shall not be construed as prohibiting a person from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided after the filing of the NOI or proposal or as requiring the further advance of money or credit.³⁴ Thus, while the counterparty to the contract cannot terminate the contract and must continue to supply product to the debtor, it can demand that it be paid on a cash-on-delivery (COD) basis for all goods and services supplied going forward. The Court of Appeal for Ontario has held that it cannot require a supplier to continue to supply product solely on the basis of security provided by the debtor.³⁵ In this respect, the BIA differs from the CCAA, the latter of which has a critical supplier clause.

Another safeguard protection is that the BIA authorizes the court, on application by a party to an agreement or by a public utility, to declare that these prohibitions on termination or

acceleration do not apply, or apply only to the extent declared by the court, where the applicant satisfies the court that the operation of those subsections would likely cause it significant financial hardship.³⁶ Thus, if the party to the agreement can satisfy the court that the operation of section 65.1(1) would cause significant financial hardship, the court can modify the order.³⁷

The public policy goal of the BIA proposal provisions is to enhance the likelihood of successful restructuring of insolvent companies by prohibiting enforcement of *ipso facto* clauses and permitting debtors to disclaim and assign contracts while treating counterparties fairly and equitably. The premise underlying these provisions is that a debtor's ability to reorganize and survive as a going concern may be stymied if the non-defaulting party refuses to supply goods and services vital to the debtor's business. *Ipso facto* clauses that require a debtor to transfer a portion of its assets or to make an accelerated payment to the non-defaulting party result in fewer assets in the debtor's estate to meet the claims of creditors, which is contrary to a central purpose of insolvency legislation. Thus, provisions rendering such clauses unenforceable are aimed at maximizing the value of assets available to be paid out to the debtor's creditors.³⁸

Considering that the provisions have been in place for three decades, there are remarkably few judgments, in large measures because they are generally considered in Canada to fairly balance the rights of creditors and debtors. The fairness to debtors is that the provisions encourage timely filing of restructuring proceedings because creditors cannot accelerate payment or terminate executory contracts only for the reason that they filed. It therefore encourages early resolution to insolvency with the assistance of professionals, collectivizing the process. The stay (moratorium) pursuant to the BIA proposal provisions and the CCAA plan of arrangement provisions gives the debtor company 'breathing room' to try to negotiate with all creditors where a viable going-forward business plan may be possible. It thus assists in avoiding premature liquidation. The fairness to creditors is that it prevents sophisticated or powerful creditors from being able to use *ipso facto* clauses to accelerate payment, which diminishes the value of the insolvency estate if the debtor is unable to get creditor acceptance and court approval of a proposal or restructuring plan and must liquidate. It is essentially another means of preventing a race to the assets or allowing a creditor to jump the queue in terms of its entitlements.

Most cases revolve around the hardship provisions. To obtain an order under section 65.1(6) lifting the stay imposed by section 65.1 on the basis of financial hardship, a creditor must prove objective hardship, not subjective hardship.³⁹ The creditor must be able to show quantitatively the financial hardship that it will suffer if the stay is not lifted; and in deciding whether to lift the stay, the court will take into account the effect of lifting the stay on the administration of the estate and the prejudice to other stakeholders; and where the hardship suffered by the applicant creditor by the court refusing to lift the stay is outweighed by the effects on the administration of the estate, the proposal proceedings and the interests of the general body of creditors, the order should not be made.⁴⁰

The Canadian court has jurisdiction to make an order for payment of amounts falling due under section 65.1(4) after the filing of a notice of intention or a proposal. Where a notice of intention to file a proposal has been filed, critical suppliers who are required to continue to supply pursuant to section 65.1 of the BIA can seek relief from the court under section 65.1(4) in order to enforce immediate payment for goods supplied to the debtor during the period after the notice of intention was filed and before the date on which the critical supplier became aware of the filing.⁴¹ The stay provisions in sections 69(1) and 69.1 do not require an application to lift the stay with respect to payments to be made under section 65.1(4) after the filing of the notice of intention or proposal but that were due prior to those dates.⁴²

The safeguards in the CCAA mirror the ones in the BIA proposal provisions. The CCAA allows counterparties to require payments to be made in cash for goods, services, use of leased property or other valuable consideration provided after the commencement of CCAA proceedings.⁴³ Section 34 also makes clear that nothing in the section is to be construed as requiring the further advance of money or credit.⁴⁴ The co-party can apply for relief on the basis of significant financial hardship.⁴⁵

While Bélanger and Rigaud observed that Parliament deliberately decided to exempt corporate bankrupts and receiverships from the prohibition on *ipso facto* clauses,⁴⁶ recent judgments at the appellate level suggest that the common law continues, at least in the case of bankruptcy, as discussed in Section 2.3.3.

Parliament implemented the hardship relief provisions to reserve flexibility in the system.⁴⁷ Its recommendations were supported by the Canadian Association of Insolvency and Restructuring Professionals (CAIRP) and the Insolvency Institute of Canada (IIC), the two leading insolvency professional organizations in Canada, and the Canadian Bar Association.⁴⁸

2.3.2 | Safe harbour exemptions

There is a safe harbour for EFC, in that they are not stayed from acting on the contractual provisions.⁴⁹ The definition of EFC was originally contained in the BIA, but was moved to the regulations in 2007 to provide greater flexibility in the definition as different types of derivatives and other EFC develop.⁵⁰ Derivatives include a contract for differences, including a total return swap, price return swap, default swap or basis swap; a futures agreement; a cap, collar, floor or spread; an option; and a spot or forward.⁵¹ Section 65.1(7) specifies that the unenforceability does not apply to EFC and does not apply to prevent a member of the Canadian Payments Association established by the Canadian Payments Act from ceasing to act as a clearing agent or a group clearer for an insolvent person in accordance with that Act and the by-laws and rules of that Association.⁵² The BIA permits the following actions under an EFC entered into before the filing that is terminated on or after that filing, but only in accordance with the provisions of that contract:

- a. the netting or setting off or compensation of obligations between the insolvent person and the other parties to the EFC; and
- b. any dealing with financial collateral including
 - i. the sale or foreclosure or, in the Province of *Québec*, the surrender of financial collateral, and
 - ii. the setting off or compensation of financial collateral or the application of the proceeds or value of financial collateral.⁵³

If net termination values determined in accordance with an EFC are owed by the insolvent person to another party to the EFC, that other party is deemed to be a creditor of the insolvent person with a claim provable in bankruptcy in respect of those net termination values.⁵⁴

When the EFC safe harbour was enacted, there was discussion concerning the appropriate balance between the economic and social policy objective of facilitating the restructuring of insolvent businesses for the benefit of all stakeholders on the one hand and the importance of the legal certainty necessary to preserve the efficiency and liquidity of the capital markets on the other.⁵⁵ Derivatives market players argued that uncertainty around the ability to enforce EFC in an insolvency represented a material risk to the efficiency, stability and liquidity of the

capital markets that depend on such instruments.⁵⁶ They argued that it was required in order for financial institutions to comply with the Basel Capital Accord in that the institution has the right to liquidate and take possession of the collateral in a timely manner; that because the essence of EFC is the mitigation of risk, if counterparties are forced to assume new insolvency risk, the benefits of entering into an EFC may not be available; and that Canadian financial markets would not be able to compete with markets in the United States and elsewhere if the safe harbour was not given.⁵⁷

As with the BIA, the CCAA provisions do not apply to EFC and members of the Canadian Payments Association acting as clearing agent in accordance with the provisions of that contract: the netting or setting off or compensation of obligations between the company and the other parties to an EFC; and any dealing with financial collateral including the sale or foreclosure or, in the Province of Québec, the surrender of financial collateral, and the setting off or compensation of financial collateral or the application of the proceeds or value of financial collateral.⁵⁸

The carve-out for EFC under the CCAA was determined after extensive consultation with the insolvency profession and financial market participants. For example, the IIC supported the EFC exception in order to protect non-defaulting counterparties from the risk of increasing exposure to the insolvent counterparty under the EFC and to reduce systemic risk in Canadian and global financial markets.⁵⁹

In summary, the codification of provisions rendering *ipso facto* clauses unenforceable, with the exception of EFC, has been uncontroversial in Canada, even after almost 30 years of experience with them. Although there are no empirical studies, the Canadian federal government confirms that there have been no reported cases contesting the provisions, and that parties generally have adjusted their commercial contracts to recognize these provisions.⁶⁰ There have been a few instances in which parties litigate whether the contract is an EFC not caught by the stay. The only other caselaw that exists tends to consider the scope of the hardship relief. Otherwise, the clarity of the language and the certainty that it brings to parties to commercial contracts has meant that it has been largely unproblematic in Canada. Combined with recent SCC jurisprudence on how the common law aligns with these provisions, discussed in the next part, the Canadian system offers a balanced approach to protection of the rights of debtors and creditors.

2.3.3 | The common law anti-deprivation rule is alive and well in Canada

In Canada, the stay on *ipso facto* clauses has recently been linked with the common law anti-deprivation rule, an important development in the treatment of contracts during insolvency. In 2020, the SCC rendered a judgment in *Chandos Construction Ltd v. Deloitte Restructuring Inc.* (*Chandos*), which held that the anti-deprivation rule operates to prevent contracts from frustrating the purposes of the BIA as it renders void contractual provisions that would prevent property from passing to the trustee, in turn helping to maximize the global recovery for all creditors in accordance with the statutory priorities.⁶¹ The SCC held that the rule continues to operate at common law in Canada, not eliminated by statute, rendering void contractual provisions that, upon insolvency, remove value that would otherwise have been available to an insolvent person's creditors from their reach.⁶²

The anti-deprivation rule has two parts: first, the relevant clause must be triggered by an event of insolvency or bankruptcy; and second, the effect of the clause must be to remove value from the insolvent's estate, an effects-based test.⁶³ Contract law and bankruptcy law work

together through the operation of the anti-deprivation rule.⁶⁴ What should be considered is whether the effect of the contractual provision was to deprive the estate of assets upon bankruptcy, not whether the intention of the contracting parties was commercially reasonable. The SCC held that the effects-based rule is clear and provides commercial certainty.⁶⁵ The SCC held that adopting a purpose-based test would create new difficulties, requiring courts to determine the intention of contracting parties long after the fact; detract from the efficient administration of corporate bankruptcies; and encourage parties that can plausibly pretend to have bona fide intentions to create a preference over other creditors by inserting such clauses.⁶⁶ The SCC held that under a purpose-based rule, unsecured creditors would receive even less than they do now.⁶⁷

The rule maximizes the assets that are available for the trustee to pass to creditors.⁶⁸ The effect of a clause can be far more readily determined and provides parties with the confidence that contractual agreements, absent a provision providing for the withdrawal of assets upon bankruptcy or insolvency, will generally be upheld.⁶⁹ The SCC recognized that there are nuances with the anti-deprivation rule; for example, contractual provisions that eliminate property from the estate, but do not eliminate value, may not offend the anti-deprivation rule; or provisions whose effect is triggered by an event other than insolvency or bankruptcy; or the rule is not offended when commercial parties protect themselves against a contracting counterparty's insolvency by acquiring insurance or requiring a third-party guarantee.⁷⁰

The *Chandos* judgment is seen as helpful as the BIA and CCAA provisions were aimed at incremental changes as both contract law and insolvency law have developed and not aimed at ousting the common law. While arguably it might leave a gap in treating of *ipso facto* clauses in receivership, interim receiverships and receivers appointed for taking urgent conservatory measures presumably do not need protection in the same way.

In summary, in Canada, the clarity of the language making *ipso facto* clauses unenforceable in insolvency law in Canada has meant that there have been few legal disputes and few judgments, other than some cases on whether a contract is an EFC and what the standard of hardship is for relief against the provisions. It is a sign that the legislation is working well, and there have been no calls for reform by insolvency professionals or civil society groups.

3 | THE UK EXPERIENCE

3.1 | Legislative history and impetus

Until the Corporate Insolvency and Governance Act 2020 (CIGA), the United Kingdom had only minimal constraints on the use of *ipso facto* clauses. The main reason for this late development is the importance of the principle of freedom to contract in the United Kingdom. Since the 19th century, the starting point for the courts has been the idea that when entering into contracts, parties are free to decide when and in what circumstances that contract should come to an end.⁷¹ Of course there have been inroads into this principle in the context of insolvency law. In particular, there is a common law rule that it is contrary to public policy to contract out of *pari passu* distribution,⁷² and the common law anti-deprivation rule provides that contractual provisions designed to remove from the estate of a bankrupt or insolvent company assets held at the commencement of bankruptcy or winding up are void as being contrary to public policy.⁷³ However, these inroads have been comparatively limited. Even as the Supreme Court

in *Belmont Park Investments Pty Ltd.* affirmed and clarified the ambit of the anti-deprivation principle, the court continued to emphasise the importance of freedom of contract:

Despite statutory inroads, party autonomy is at the heart of English commercial law...it is desirable that, so far as possible, the courts give effect to contractual terms which parties have agreed.⁷⁴

In *Belmont*, the Supreme Court called for a ‘common sense’ approach to the application of the rule that would prevent it from disturbing:

bona fide commercial transactions which do not have as their predominant purpose...the deprivation of the property of one or more parties on bankruptcy.⁷⁵

The test established by the Supreme Court in *Belmont* therefore involves an assessment in every case of whether the transaction is a commercially sensible one entered into in good faith. After *Belmont* the position was that while *ipso facto* clauses constituted a ‘deprivation’ that would attract the application of the rule, the inclusion of a provision entitling one party to terminate on another’s entry into insolvency proceedings would generally be considered commercially sensible and would survive the application of the anti-deprivation rule.⁷⁶

In this context, it is perhaps unsurprising that, prior to CIGA, the constraints on *ipso facto* clauses that had been introduced in the United Kingdom were limited in scope, being focused on preserving the supply of utilities such as gas, water and electricity and other ‘essential’ goods and services.⁷⁷ ‘Essential supplies’ are narrowly defined however, so that in practice, prior to CIGA, an insolvency office holder could only compel the continued supply of utilities and various forms of IT supply, so long as the company continued to pay for them.⁷⁸ The operation of these sections was limited to situations where the company entered administration or a Company Voluntary Arrangement. CIGA introduced a new section 233B into the Insolvency Act 1986,⁷⁹ which significantly expands these provisions and introduces a broad and far-reaching constraint on *ipso facto* clauses. These changes represent a material policy shift.

The immediate prompt for the introduction of these changes was the financial crisis created by the COVID-19 pandemic and, in particular, the financial distress it created for numerous otherwise viable companies. CIGA contains a range of measures, some temporary, others permanent, to tackle these difficulties. The main permanent measures are the introduction of a new restructuring mechanism, the restructuring plan, which enables a cross-class cramdown to take place,⁸⁰ the introduction of a restructuring moratorium,⁸¹ and a broad constraint on *ipso facto* provisions.⁸²

This set of permanent measures, including the *ipso facto* reforms,⁸³ had their genesis in a 2016 consultation paper from the UK Insolvency Service⁸⁴ and a set of 2018 proposals by the UK Government, which responded to that consultation,⁸⁵ although the provisions in CIGA are not identical to the proposals in those earlier papers, and indeed involve more radical reform regarding *ipso facto* clauses than was proposed by the Insolvency Service in 2016. While concerns around the financial difficulties created by the COVID-19 crisis were undoubtedly an important prompt for these reforms, there were also other significant drivers. These include a measure of regulatory competition as jurisdictions around the world have unveiled their debt restructuring proposals. There has also been increased political focus in the United Kingdom and elsewhere on rescuing companies, through indicators such as the World Bank’s Doing Business figures.⁸⁶

3.2 | Scope of unenforceability of *ipso facto* clauses

Section 233B of the Insolvency Act 1986 provides that any provision that allows for the termination of a contract for the supply of goods and services or for a party to do ‘any other thing’ when a counterparty enters into a relevant insolvency procedure ceases to apply once the counterparty enters into that relevant insolvency procedure. CIGA therefore seeks to maximize the opportunities for the rescue of businesses reliant on the continuation of supply agreements. Although the UK provisions introduced in CIGA take their inspiration from constraints on *ipso facto* clauses elsewhere, such as those in the US Chapter 11 Bankruptcy Code provisions, they are distinct from the equivalent provisions in other jurisdictions, narrower in some aspects and broader in others.

The stated policy intention of the new constraint on *ipso facto* clauses is to help companies trade through a restructuring or insolvency procedure, maximizing the opportunities for rescue of the company or the sale of its business as a going concern.⁸⁷ The constraint applies in the event that a company enters an ‘insolvency procedure’.⁸⁸ This procedure is defined to include a moratorium, including therefore the restructuring moratorium introduced by CIGA, administration, a Company Voluntary Arrangement, liquidation, or a restructuring plan.⁸⁹ The inclusion of liquidation in this list arguably looks odd given the purpose of this provision is to aid the rescue of a company as a going concern or of its business.⁹⁰

Clearly, the principle of freedom of contract can be constrained for policy reasons that extend beyond corporate rescue. The development of the anti-deprivation principle, for example, recognizes that contractual arrangements can be used to undermine the statutory insolvency process in a way that diminishes both the potential for rescue and the ability of a liquidator to get in the assets, realize them and distribute them in accordance with the statutory order of distribution.⁹¹ The stated aim of rescue, however, does not seem to encompass a situation where no rescue objective exists, so, for example, in the more typical liquidation scenario in the United Kingdom where the company ceases to trade almost immediately. To justify the constraint on *ipso facto* clauses in such a situation requires a clear policy statement, and the lack of such a statement may create problems later. For example, creditors making a hardship application to court (see Section 3.3) may seek to persuade the courts to take into account the question of whether a rescue rationale exists, perhaps suggesting that supplier risk is not justified where a rescue or preservation of the business for the purposes of a sale is not in prospect.

The constraint on *ipso facto* clauses introduced in CIGA is triggered by formal insolvency of the company or entry into one of these procedures rather than actual insolvency. A termination clause based simply on the company’s inability to pay its debts (cash flow or balance sheet insolvency) will therefore remain exercisable before the company enters a formal insolvency process. It will be unfortunate if this focus on formal insolvency results in suppliers exercising termination clauses at the first sign of a company’s distress (in order to avoid the ban should the company go into a formal insolvency procedure), thereby precipitating the company’s descent into insolvency. If premature insolvency filings occur, it will undermine the rescue objective underpinning these provisions.

The provisions now in section 233 of the Insolvency Act 1986 have two main effects.⁹² First, a supplier’s contractual right to terminate on the grounds of insolvency is permanently switched off as from the date of the relevant insolvency procedure.⁹³ The prohibition is on termination or ‘any other thing’⁹⁴ by reason of insolvency. The reference to ‘any other thing’ is extremely broad. It includes exercising any other contractual rights triggered by or exercisable upon the commencement of an insolvency procedure and includes any provision requiring higher

payments or payments on default, for example, default interest or an acceleration of unpaid payments. These provisions also cover the invalidation of any guarantee in the supplier's favour where the supplier would be prevented from making any claim under such guarantee as a result of the company's insolvency.

The provisions specifically prohibit the supplier from making it a condition of continued (post-insolvency) supply that outstanding charges are paid.⁹⁵ However, suppliers will retain the right to terminate or 'do any other thing' with respect to any *non-insolvency related* events contained in the contract, where the event occurs *after* the commencement of the insolvency procedure. These rights may include, for example, non-payment. Second, a supplier's contractual right to terminate on the grounds of any pre-insolvency events of default are temporarily suspended until the relevant insolvency procedure comes to an end (unless the company exits into a subsequent insolvency procedure).⁹⁶

CIGA provides that the prohibition of termination on the basis of insolvency covers contracts for the supply of goods and services other than contracts excluded from the operation of the section. Various contracts are excluded from its scope, such as an insolvent company's customer contracts. This constraint on *ipso facto* clauses is therefore narrower than some of the constraints elsewhere in the world, such as that within US Chapter 11, which generally applies to all executory contracts (subject to carve-outs).⁹⁷

3.3 | Safeguards and exemptions

3.3.1 | Safeguards

As in other jurisdictions, the UK regime includes a series of safeguards for suppliers of goods and services, and exemptions for particular types of contracts in the financial sector. It is clear that a constraint on *ipso facto* clauses can be beneficial to companies in financial distress, and to the creditors generally, particularly if the constraint promotes the rescue of the company or its business, but there is a balance to be struck between these benefits to the debtor and the rights of the individual creditors, which are otherwise being overridden. A measure of creditor protection is built into the UK provisions.

One means of achieving this protection is via the payments that the supplier can expect for continuing to supply goods or services to the debtor. In Canada creditors can demand payment on a COD basis. A different approach is utilized in the United Kingdom. Under the pre-CIGA provisions, suppliers were protected by their ability to demand a personal guarantee from the officeholder for post-insolvency charges (failing which the supply can be terminated). By contrast, in the new provisions, introduced in CIGA, there is no requirement for the insolvency practitioner to supply a personal guarantee.⁹⁸

A further form of protection that is commonly utilized is the ability of the supplier to terminate the contract in certain circumstances despite the general ban. In the United Kingdom, there are three such exceptions, whereby termination by a supplier on account of an insolvency event will be permitted:

1. with the consent of an office holder (i.e., an administrator or liquidator) or the company itself, if it is subject to debtor-in-possession proceedings, such as a restructuring plan or a CVA⁹⁹;
2. with the approval of the court, where continuation of the contract would cause the supplier hardship¹⁰⁰; and

3. if a post-insolvency event of default occurs, giving rise to a new event of default, such as non-payment.¹⁰¹

In practice, it is this second exception, based on creditor hardship, which is likely to be the focus for creditors seeking to terminate the contract despite the ban. However, the concept of ‘hardship’ is not defined within the legislation and it will therefore be for the courts to establish this threshold. This is the same terminology as adopted in Canada and, as discussed, most of the cases in the Canadian courts have revolved around the hardship provisions. Different courts will have to develop their own definitions of this concept, and it makes sense for them to look to similar situations within their own jurisdiction for guidance. It may be that the UK courts will apply the concept of balance that they have developed in relation to creditor challenges to the UK administration moratorium, whereby the hardship to the individual creditor is balanced with the benefits to the creditors as a whole in light of the overarching aim of securing the rescue of the company or business.

A high hurdle is imposed for the individual creditor: the court will relax the prohibition where it is demonstrated that it would be ‘inequitable’ for the prohibition to apply.¹⁰² If a similar threshold is applied to this scenario, it is likely that ‘hardship’ will be interpreted to mean the possible insolvency of the supplier if it is forced to continue to supply. This interpretation would seem to be what the Government has in mind; it has described the hardship test as a ‘safeguard of last resort’, suggesting that it may be of limited value to suppliers.¹⁰³ Furthermore, this form of protection requires suppliers to go to the trouble and expense of litigation, something that is likely to dissuade many, particularly small suppliers, from seeking this form of protection.¹⁰⁴ The level of creditor protection provided by this provision may therefore be less than it appears at first sight.

3.3.2 | Safe harbour exemptions

In common with other jurisdictions, the UK constraint on *ipso facto* clauses is subject to carve-outs for certain kinds of creditor. The categories of supplier and categories of contract, which are excluded, are set out in Schedule 4ZZA of the Insolvency Act 1986.¹⁰⁵ There are also exclusions where the termination clause forms part of a contract involving financial services.

In summary, loan agreements, hedging arrangements and other types of financial contracts are carved-out of the application of section 233B; and certain entities (e.g., deposit-taking and investment banks and insurance companies) are excluded from the effects of the section, regardless of whether they are the insolvent entity or the supplier.¹⁰⁶ There is also a carve-out for any set-off, netting arrangements or capital market investments. These carve-outs largely mirror those that exist in other jurisdictions, including the US Bankruptcy Code. They will be welcomed by financial creditors as it will enable them to, among other things, withdraw committed funds on the commencement of the relevant insolvency process (and thus mitigate against risk), charge default interest on overdue amounts and accelerate debt in order to enforce security and call upon guarantees on the occurrence of an insolvency event. Excluded contracts largely relate to financial services,¹⁰⁷ and the changes to the law introduced by CIGA will, consequently, largely affect trade creditors. There is some sense to the exclusion of financial creditors. In the absence of this carve-out, financial creditors may have been prompted to incorporate earlier triggers into financial documentation to enable them to withdraw from the

company working capital necessary for the company's ongoing operation at a point when insolvency is reasonably likely, to avoid the effects of the *ipso facto* ban, an outcome that could be more detrimental to a distressed company than excluding the financial creditors from the ambit of these provisions.

The changes introduced around the enforceability of *ipso facto* clauses in 2020 via CIGA represent a significant shift in policy in the United Kingdom. Despite the carve-outs described above, the effect of the 2020 reforms is to expand significantly the ambit of the constraints on enforceability of *ipso facto* clauses that apply in the United Kingdom. Although, in many ways, the form of the post-2020 constraints on *ipso facto* clauses in the United Kingdom mirrors those elsewhere, there are reasons to be concerned about some of these changes. The speed with which the legislation was introduced, in response to the COVID-19 pandemic, means that the provisions were not, perhaps, scrutinised quite as closely as might otherwise have been the case. Some key terms, such as the 'hardship' creditors will need to demonstrate if they wish to terminate the contract despite the constraints, are left largely undefined by the statutory provisions. Other aspects of the legislation, such as the precise ambit of the phrase 'any other thing', will also take time to settle. The example of equivalent Canadian provisions suggests that these issues may iron themselves out over time, as parties get used to the provisions and can adapt to them in future contract negotiations. This, however, makes the retrospective nature of the UK changes introduced via CIGA particularly hard to justify.

4 | THE GERMAN EXPERIENCE

In contrast to Canada or the United Kingdom, German law contains two separate and significantly different regulations on *ipso facto* clauses ('Lösungsklauseln'). German insolvency law has featured an ambiguous statutory position on such clauses in section 119 of the Insolvenzordnung (InsO) (German Insolvency Code), which will be explained in this part of the article. The implementation of the EU Restructuring Directive¹⁰⁸ into German law created a new statutory framework for preventive restructuring procedures, which also included a statutory ban of *ipso facto* clauses, which renders such clauses null and void. As these provisions result from policy choices made by the EU legislator, they are discussed separately (below in Section 5.4).

The German insolvency law on *ipso facto* clauses presents the remarkable case of a seemingly unending debate about a well-balanced compromise between the Canadian and English 'extremes'. The debate centres on section 119 of the InsO, which reads:

Agreements excluding or limiting the application of sections 103 to 118 in advance shall be invalid.

This prohibition protects the right of the insolvency administrator to assume or reject executory contracts granted in sections 103–108 of the InsO.

4.1 | Legislative history and impetus

German insolvency law has never included any explicit regulation on *ipso facto* clauses, but it has always prohibited and invalidated contractual agreements that directly limited or rearranged the right of the insolvency administrator to accept or reject executory contracts as

such modifications hindered the administrator in maximizing the value of the estate.¹⁰⁹ Whether the prohibition extended to contractual clauses that did not directly, but merely factually, interfere with these rights, such as *ipso facto* clauses, has been a topic of constant debate. It started based on a very liberal case law under the old bankruptcy laws (KO and VgLO) before 1999, which – similar to the case law in the United Kingdom at the time – principally respected the right of contractual parties to adopt *ipso facto* clauses.¹¹⁰

In 1978, a reform commission¹¹¹ was instituted in order to design a new insolvency statute that was meant to replace the old statutes. The commission's report in 1985 included a specific proposal with regard to *ipso facto* clauses and, while mentioning that there was no unanimous position, proposed to ban such clauses by rendering them null and void.¹¹² It was the majority view that such contractual termination rights would jeopardize the continuation of the debtor's business and that the interests of contracting parties were sufficiently protected by allowing them to terminate or accelerate contracts whenever an actual event of default occurred (no performance, late performance, etc.). The minority in the commission objected with a view to the well-established German practice of accepting such clauses as valid and the trust invested in this principle across industry sectors.

The ensuing legislative process initially adopted the (majority) position of the commission and included relevant provisions into the draft text of the InsO in 1992. Section 137¹¹³ repeated the well-known prohibition on agreements (directly) limiting the rights of the insolvency administrator with regard to executory contracts in its first paragraph before detailing two new specific rules for *ipso facto* clauses in the subsequent paragraphs. Paragraph 2 explicitly prohibited the use of such clauses in contracts provided that they simply connected to the fact of the commencement of insolvency proceedings (insolvency-related *ipso facto* clauses). Paragraph 3 stated that the prohibitions in the first two paragraphs do not affect contractual rights for late payments or any other form of breach of contractual duties.

Unfortunately, section 137 of the draft law suffered significant amendments in Parliament in 1994. Following an exchange of arguments in the Parliamentary Committee on Legal Affairs, the second and third paragraphs in section 137 were deleted without any replacement based on the view of the Parliamentary Committee that mere factual impediments of the rights of the insolvency administrator would not justify a strict prohibition of *ipso facto* clauses. Firstly, such a ban would significantly limit the freedom of contract without a sufficient supporting cause. Secondly, the Parliamentary Committee adopted the view of German practice that the new ban would hinder, rather than support, rescue operations in failing businesses because it would deter business partners in the critical time period of a preventive rescue attempt as they had no way of limiting their engagement if the attempt failed. Thirdly, it was stated the international contractual standards commonly include such clauses and that they should remain valid in Germany.¹¹⁴

So eventually, the InsO went into force in 1999 without containing any specific provision regarding *ipso facto* clauses (again). While Parliament had uttered a clear position in favour of the validity of such clauses, the contrary position of the reform commission remained well and alive, and its proponents used the prohibition in section 119 of the InsO to argue in favour of a limited ban on *ipso facto* clauses – a position that was actually adopted by the Federal Supreme Court 13 years later.¹¹⁵

4.2 | Scope of the German *ipso facto* ban

Firstly, there has always been a general consensus in Germany that the insolvency of a party to a contract or the commencement of insolvency proceedings shall not affect or limit the (statutory) rights of the counterparty deriving from a breach of contract (late performance, no

performance). The sole exception to this principle is explicitly included in section 112 of the InsO limiting the termination rights for late payments of the debtor in lease and rental contracts in insolvency proceedings. Beyond this special provision, it is generally agreed that contractual clauses connecting to events of default (non- insolvency-related *ipso facto* clauses) are valid and may well be invoked after insolvency proceedings were filed or commenced.¹¹⁶

Secondly, the prohibition of remaining insolvency-related *ipso facto* clauses, which are agreements that provide a right to terminate or accelerate a contract merely due to the fact that the debtor is insolvent, is deduced from section 119 of the InsO. Thus, the ban may only include clauses in executory contracts as defined in section 103 of the InsO (not, for instance, articles of association under company law) and, further, in executory contracts where the right to terminate or assume is actually granted to the insolvency administrator under section 103 of the InsO and not derogated by explicit provisions in sections 104–118. These provisions include derogations for financial contracts (section 104 of the InsO), lease or rental contracts for real estate and employment contracts (section 108(1) of the InsO), loan agreements (section 108(2) of the InsO) and agency contracts (sections 115–117 of the InsO). As the insolvency administrator does not have an election right in these cases, *ipso facto* clauses may not interfere and cannot be banned. A relevant prohibition of *ipso facto* clauses was stated by the Federal Supreme Court to supply contracts for goods and energy.¹¹⁷ The line of arguments could potentially also affect such clauses in licensing contracts.

If a prohibition applies, it includes all clauses relating to the insolvency of the debtor, either by connecting to the motion for or the commencement of insolvency proceedings or by connecting to the debtor's inability to pay or balance sheet insolvency (the relevant German insolvency tests). The ban would preclude the counterparty from invoking the rights under the clause retroactively back to the moment when the insolvency of the debtor is imminent.¹¹⁸

Thirdly, even an insolvency-related *ipso facto* clause is not prohibited if it merely mirrors a statutory right under contract or commercial law.¹¹⁹ Statutory *ipso facto* clauses are indeed prominently featured in German law, for instance, in insurance¹²⁰ law or in the law on construction contracts.¹²¹

The limited scope of the remaining ban may be mitigated in cases where the execution of such clauses by the counterparty results in a loss of value for the estate due to the application of German insolvency law rules on avoidance actions and fraudulent transfers. While the relevant case law of the Federal Supreme Court¹²² predates the InsO and is not easily transferred to today's law, the decision is still relevant in principle and may well be upheld.

4.3 | Safeguards and exemptions

As the ban of *ipso facto* clauses is not specifically regulated but rather deduced from a general protection of the right of the insolvency administrator, there are also no explicit provisions on safeguards and exemptions.

4.3.1 | Safeguards

If the contractual counterparty may not invoke an *ipso facto* clause due to the application of section 119 of the InsO, it is the insolvency administrator's right and duty to terminate or assume the executory contract pursuant to section 103(1) of the InsO. Section 103(2)2 of the

InsO enables the counterparty to prompt such an election immediately. If the contract is terminated, the counterparty may file a damages claim against the estate, which ranks as a general unsecured claim pursuant to section 103(2)1 of the InsO. If the contract is assumed, the claim for performance of the counterparty ranks as an administrative expense pursuant to section 55 (1) no. 2 of the InsO and may generally expect to be paid in full. German insolvency law does not foresee any discretion of the court to amend this regime, for example, due to individual hardship for the contractual counterparty.

If, however, the *ipso facto* clause is valid, the counterparty may either invoke it or nonetheless leave the decision to the insolvency administrator by requesting the election under section 103(1) of the InsO.

4.3.2 | Safe harbour exemptions

The limited scope of the ban produces a larger safe harbour similar to the exemptions under Canadian or UK law. Financial contracts, broadly defined in section 104 of the InsO, are exempted from the right of the insolvency practitioner to assume or reject and thus also exempted from a ban protecting this right. The same logic applies to other types of executory contracts that are terminated or assumed automatically by law, in particular real estate lease or rental contracts and employment contracts (section 108 (1) of the InsO), or loan agreements (section 108(2) of the InsO), but also for contracts that are not even executory contracts.

Overall, German insolvency case law only provides for a very limited ban of *ipso facto* clauses beyond the background of a contested legislative decision not to prohibit such clauses expressly. For many types of contracts, it is still an open legal question whether commonly used *ipso facto* clauses fall within the scope of the ban. Today's legislator relies on the German courts to further develop the scope of the ban. Similar to the situation in the United Kingdom, more certainty might be available over time.

5 | THE INTRODUCTION OF *ipso facto* REGULATION BY THE EU LEGISLATOR

The EU Restructuring Directive¹²³ aims to ensure that every Member State has in place an effective debt restructuring mechanism that can facilitate the rescue of financially distressed yet viable companies.¹²⁴ The Preventive Restructuring Framework outlined in the first substantive part of the Directive does not aim at improving restructuring options in existing insolvency frameworks of EU Member States. Instead, it looks at procedures that are or should be available before a debtor becomes insolvent under national law, namely before the debtor fulfils the conditions under national law for entering collective insolvency proceedings, which normally entail a total divestment of the debtor and the appointment of a liquidator.¹²⁵ The Directive requires EU Member States to revise their laws in order to offer preventive restructuring procedures containing a package of measures such as a restructuring professional accompanying the debtor-in-possession, a moratorium, a restructuring plan containing classes of creditors and a cross-class cramdown option, and measures to deal with *ipso facto* clauses.

5.1 | Legislative history and impetus

The purpose of constraining the use of *ipso facto* provisions is stated in the recitals as being to ensure the successful rescue of the business.¹²⁶ This broad purpose leads the EU legislator to adopt two separate provisions banning rights of the counterparty.

Firstly, Article 7(5) contains a ban on *ipso facto* clauses:

5. Member States shall ensure that creditors are not allowed to withhold performance or terminate, accelerate or, in any other way, modify executory contracts to the detriment of the debtor by virtue of a contractual clause providing for such measures, solely by reason of:

- a. a request for the opening of preventive restructuring proceedings;
- b. a request for a stay of individual enforcement actions;
- c. the opening of preventive restructuring proceedings; or
- d. the granting of a stay of individual enforcement actions as such.

Contractual clauses connecting solely to the fact of taking procedural steps in a restructuring or insolvency framework would not be valid or at least not enforceable.

Secondly, Article 7(4) expands the ban beyond traditional *ipso facto* clauses:

4. Member States shall provide for rules preventing creditors to which the stay applies from withholding performance or terminating, accelerating or, in any other way, modifying essential executory contracts to the detriment of the debtor, for debts that came into existence prior to the stay, solely by virtue of the fact that they were not paid by the debtor. ‘Essential executory contracts’ shall be understood to mean executory contracts which are necessary for the continuation of the day-to-day operations of the business, including contracts concerning supplies, the suspension of which would lead to the debtor’s activities coming to a standstill.¹²⁷

The first sub-paragraph shall not preclude Member States from affording such creditors appropriate safeguards with a view to preventing unfair prejudice being caused to such creditors as a result of that subparagraph. Member States may provide that this paragraph also applies to non-essential executory contracts.

This provision prohibits the right of the counterparty to affect the contract based on an event of default (no payment) regardless of the statutory or contractual basis of the right in order to secure the continuation of the business.¹²⁸ Such a strict prohibition has no precursor in Canadian, English or German law.

5.2 | Scope of the EU *ipso facto* ban

The scope of the EU ban is broader than those in the other jurisdictions analysed in several aspects.

The ban of contractual *ipso facto* clauses in Article 7(5) is broader than both the UK provisions introduced in 2020 and the German ban in insolvency proceedings as it principally applies

to all executory contracts, not just suppliers of goods and services. Similar to German insolvency law and contrary to the UK provisions, the Directive limits the ban in Article 7(5) to ‘restructuring-related’ clauses while it permits clauses that connect to other, additional grounds such as a late payment.

It is Article 7(4) that extends the ban beyond contractual clauses and beyond clauses connecting to the mere fact of entering procedures by encompassing statutory rights of the counterparty for non-payment. The very broad scope of this prohibition is confined by two aspects. Firstly, it only applies to ‘essential executory contracts’, defined as executory contracts ‘necessary for the continuation of the day-to-day operations of the business, including contracts concerning supplies, the suspension of which would lead to the debtor’s activities coming to a standstill’. Yet it is explicitly provided that Member States may extend the provision to also encompass non-essential executory contracts. Secondly, the ban only limits the rights of creditors to whom a stay applies. As Article 6 allows EU Member States to specify the details of such a stay including provision for exemptions, the scope of the ban will probably differ significantly across Member States.

It needs to be remembered, however, that these provisions are only applicable to parties in a preventive debt restructuring mechanism implemented according to the Directive. The scope of the EU *ipso facto* ban is narrower than those in the United Kingdom and in Canada where, by contrast, the *ipso facto* provisions apply much more broadly and include the situation where the company is in liquidation, leading to a separate set of rules for preventive procedures in Germany.

5.3 | Safeguards and exemptions

On the face of the Directive, the encroachment into freedom of contract is clear, and significant, but the potential protections for creditors on this issue, such as those in the US Bankruptcy Code or section 233B of the UK Insolvency Act 1986, are missing. Indeed, Article 7(4) makes it clear that this issue is left to Member States since it leaves open to Member States the option of affording creditors ‘appropriate safeguards with a view to preventing unfair prejudice’. Clearly this approach leaves a lot of discretion to Member States and could lead to these provisions being implemented in very different ways in different Member States.

Similar to the provisions in the United Kingdom and Germany, the EU *ipso facto* ban is only affecting the rights of a counterparty in executory contracts. *Ipso facto* clauses in other contracts are exempted. The term ‘executory contracts’ is broadly defined as contracts between debtors and counterparties under which both sides still have obligations to perform at the time the stay of individual enforcement actions is ordered,¹²⁹ and would also include financial contracts. Article 7(6) authorizes Member States to provide that a stay of individual enforcement actions does not apply to netting arrangements, including close-out netting arrangements, on financial markets, energy markets and commodity markets, if such arrangements are enforceable under national insolvency law. This provision does not amount to an exemption of financial contracts to the extent we see in the United Kingdom, German and Canadian provisions or in the US Bankruptcy Code. Such an exemption does also not follow from the fact that Article 1(2) provides a long list of debtors to whom the provisions of the Directive do not apply, including insurance undertakings, credit institutions, investment firms, central counterparties, etc., and that Article 1(3) provides that Member States may exclude from the scope of these Directive procedures that concern debtors that are financial

entities, other than those referred to in Article 1(2). All these provisions concern the debtor being the financial institution and do not extend to excluding counterparties that are financial institutions.

5.4 | The German implementation in sections 44 and 55 of the StaRUG

In Germany, the Parliament proposed a reform bill in late 2020, which was then passed and came into force on January 1, 2021.¹³⁰ This bill included, amongst other reforms, the introduction of a preventive restructuring framework as described by the Directive in a new statute: ‘Gesetz über den Stabilisierungs- und Restrukturierungsrahmen für Unternehmen’ or ‘StaRUG’. This amendment represented a significant shift in German law as prior to the implementation of these provisions, German law only provided for either out-of-court restructurings requiring the consent of all affected creditors and shareholders or in-court restructurings by means of an insolvency plan under the InsO.

Implementing Article 7(4) and 7(5) of the Directive, the German StaRUG regime includes a ban of *ipso facto* clauses (‘Lösungsklauseln’) and other rights of the counterparty in sections 44(2) and 55(1) of the StaRUG.

Section 44 of the StaRUG implements Article 7(5) by providing:

Section 44 – Prohibition of Termination Clauses

1. The notification of the restructuring case or the use of tools of the stabilisation and restructuring framework by the debtor is not in and of itself justification
 - i. for terminating contracts to which the debtor is a party;
 - ii. for accelerating the due date of payments or performance; or
 - iii. for entitling the other party to refuse the payment or performance incumbent on it or demanding modification or renegotiation of the contract.

They also do not in and of themselves affect the effectiveness of the contract.
2. Agreements that conflict with subsection (1) are invalid.
3. Subsections (i) and (ii) do not apply to transactions pursuant to section 104 (1) of the Insolvency Code, to agreements on close-out netting pursuant to section 104 (3) and (4) of the Insolvency Code or to financial collateral within the meaning of section 1 (17) of the Banking Act. The foregoing also applies to transactions that are subject to the settlement of claims and performance as part of a system pursuant to section 1 (16) of the Banking Act.

Section 44 therefore provides that creditors’ rights to alter a legal relationship by unilateral declaration, for example, by termination of contract, calling in receivables or a refusal to perform, cannot be exercised in a pending restructuring matter and any contractual provisions to the contrary are deemed invalid. This prohibition extends to demanding ‘adjustments to or other modification of the relevant contract’, which is presumably the ‘any other thing’

equivalent in this context. Any termination or acceleration right or rights of retention based on other grounds, however, remain unaffected.

Interestingly, the reference to section 104 of the InsO in section 44(3) of the StaRUG effectively excludes financial contracts and their netting agreements from the scope of the ban. This exclusion is largely in line with the principles known from the debate about section 119 of the InsO, but a clear deviation from the missing exemption in the Directive.

In contrast to both the scope of the EU *ipso facto* ban and the scope of a ban under German insolvency law, section 44(1) of the StaRUG extends the ban in preventive procedures to all contracts of the debtor. There is neither a reference to executory contracts as defined in section 103 of the InsO nor a condition to the existence of an election right for such a contract, which would give relevance to the (other) exceptions in sections 104–118 of the InsO. Hence, the scope of the StaRUG *ipso facto* ban is significantly larger than that of an InsO ban, or a ban in other Member States strictly implementing the provisions in Article 7 (5) of the Directive.¹³¹

Further, section 55 limits the use of statutory rights from a late payment of the debtor in line with Article 7(4) of the Directive if a stay of enforcement actions ('stabilisation order') is issued against the counterparty:

Section 55 – Effects under Contract Law

1. If the debtor owes a creditor something under a contract at the time of a stabilisation order, the creditor may not, solely by virtue of a late performance, refuse to provide its performance during the period of the order or execute rights to terminate or modify the contract; the foregoing does not affect the creditor's right to refuse to provide that portion of its performance that is attributable to the performance owed by the debtor. If extended or renewed orders are issued, the time of the initial order is decisive.
2. Subsection (1) does not apply if the debtor is not reliant upon the creditor's performance for the continued operation of the business.
3. If the creditor is obligated to perform in advance, it has the right to make its performance contingent on the posting of security or on the debtor providing its performance concurrently. Subsection (1) does not affect the right of lenders to terminate the loan contract prior to disbursement of the loan due to a deterioration in the debtor's financial circumstances or in the value of the collateral provided for the loan (section 490 (1) of the Civil Code). Sentence 2 also applies to other loan commitments.

The provision applies only to executory contracts and requires the counterparty that is affected by a stay to continue to perform as promised even though the debtor defaulted on its obligation before. The creditor may, however, insist on a payment of the debtor for the new continued performance (cash on delivery). Paragraph 2 effectively limits the ban to *essential* executory contracts. Paragraph 3 extends the right to demand cash or collateral on delivery to counterparties who would otherwise need to perform in advance. It also protects *ipso facto* clauses for lenders. Further, financial contracts are explicitly excluded from the scope of a stay pursuant to section 56.

Overall, sections 44 and 55, 56 StaRUG implement the rules of the Directive without any reference to the pre-existing German insolvency rules developed for such clauses under

section 119 of the InsO. Effectively, the InsO and the StaRUG regime for *ipso facto* clauses are separate and independent both legally and principally.

6 | PRINCIPLES AND POLICY CHOICES INFORMING STATUTORY CONSTRAINTS ON *ipso facto* CLAUSES

The analysis of the Canadian, United Kingdom, European Union and German rules for *ipso facto* clauses makes it clear that largely divergent regimes have developed based on the discussion of a similar set of principles and arguments. When revising their regime on *ipso facto* clauses, often in connection with a general insolvency or restructuring law reform, policymakers should follow a sequence of steps in their decision-making.

6.1 | Step 1: Clarity on the underlying rationale for interfering with parties' freedom to contract

Any policy discussion in this area should begin with a basic decision about the rationale of the envisioned or existing *ipso facto* clause regulation. The German insolvency law example provides proof of the amount of uncertainty in a jurisdiction when this discussion remains largely unfinished.

Two broad approaches can be observed. The first is to rationalize the constraints on *ipso facto* clauses as necessary to preserve the debtor's business operations in a crisis or insolvency. This approach may be regarded as a particularly strong-form debtor-friendly approach, justifying constraints on *ipso facto* clauses as necessary to preserve the debtor's business with the pre-insolvency owners. It is based on a restructuring (rather than insolvency) approach. Where policymakers have such a legislative agenda, as, for instance, the EU legislator did when banning *ipso facto* clauses in order to secure restructuring options, or the former German legislators when deciding against a statutory prohibition, this rationale should be expressed clearly and guide the subsequent steps in the legislative process.

The second approach contains a broader rationale for the constraints that go beyond preserving the business with the pre-insolvency owners. It recognizes that such constraints can have the purpose of safeguarding the going-concern value of a business until a decision is made in a formal process about whether to restructure, sell or wind it down. Preserving going-concern value is good for the debtor company if a restructuring ensues, but it is also good for the general body of creditors as the value of the estate is maximized by preserving the going-concern value even if the business is then sold as a going concern in liquidation proceedings. As such, a ban on enforceability of *ipso facto* clauses may improve the expectations for both the debtor and the estate and thus the general body of creditors. Adopting this second approach requires a legislator to state clearly that such a wider purpose is being pursued and that this policy rationale is why an individual creditor should lose a contractual right in order to improve these expectations. It is the individual, often sophisticated, contract creditor versus the collective interest of all creditors that must be balanced here, and the design of an *ipso facto* clause regime balancing them will probably look different than one implementing the first approach, in particular in terms of scope (restructuring versus insolvency frameworks) and safeguards.

The principal policy choice to regulate the use of *ipso facto* clauses in the first place is often framed as one about the extent to which freedom of contract should be infringed. Indeed,

insolvency and restructuring law principles seem ambiguous in handling contractual arrangements that aim at fixing the position of one party in case of the other party's insolvency. On the one hand, any contractual right based on a contract clause is a pre-bankruptcy entitlement and basically respected in insolvency just like a security interest or an arrangement about the seniority or subordination of rights. On the other hand, insolvency law does not respect acts of an individual creditor that are detrimental to the general interest of creditors and either avoids such acts or recovers transactions that effect such a harm to the common interest. Hence, the principles of insolvency and restructuring law cannot assist much in making this first-step policy decision. It remains a policy decision whether and for which purpose the law should curtail the use of individual rights of a counterparty in the specific circumstances of insolvency or distress.

Today, many jurisdictions have introduced limitations, and amongst those who have, we see no agreement about whether to follow the first or second of the approaches described above. Indeed, there is disagreement between jurisdictions as to whether clauses that make *ipso facto* clauses unenforceable in insolvency proceedings should be available only for restructuring/reorganization or whether they should be available for liquidations, either in all cases or only in cases where the business is being liquidated on a going-concern basis. The first approach (restructuring protection) seems to find support in recent law reforms in the EU as well as in relevant international standards.¹³² The second approach (going concern protection both in a liquidation and restructuring) is also mentioned in these international standards where the argument is that such clauses may work to:

keep the business together to maximize its sale value or to enhance its earnings potential; to capture the value of the contract for the benefit of all creditors rather than forfeiting it to the counterparty; and the desirability of locking all parties into the final disposal of the business.¹³³

German insolvency case law seems to support this view. The German legislative process, however, also points to a key argument against a ban on enforceability of *ipso facto* clauses as such a regime effectively disables the parties to an agreement with a distressed firm from autonomously determining the fate of contractual rights in case of a further deterioration of the firm's financial status. This inability might keep them from contracting and supporting such businesses when they need this support most. Suppliers, for instance, could cease supplying even before relevant restructuring or insolvency proceedings are even initiated, and a ban on such a cessation becomes effective. Experiences with *ipso facto* regulations in jurisdictions such as Canada seem to indicate, however, that these concerns may be unjustified.

Finally, concerns about regulatory competition might suggest that jurisdictions should avoid such constraints at least while such constraints remain relatively uncommon globally, on the basis that those introducing limits on the use of *ipso facto* clauses might suffer an economic disadvantage. Again, such concerns do not seem to be supported empirically if we look at the experience of jurisdictions that provide for such a regime. The reason why these jurisdictions avoid economic disadvantages might be found in the fact that they provide for exemptions from their *ipso facto* regime for specific types of contracts, such as shipbuilding or financial contracts, where market participants hold the use of certain *ipso facto* clauses as established and essential, especially in cross-border contracts. In conclusion, this aspect should prompt policymakers to consider such exemptions carefully, but they might not justify a decision to not regulate such clauses at all.

6.2 | Step 2: Clarity in the scope of rules on limiting the enforceability of *ipso facto* clauses

Once a policymaker has adopted the relevant rationale for a (new) *ipso facto* clause regime, the specific design of this regime would first need to outline the scope of restrictions with utmost clarity.

6.2.1 | Which kind of proceedings shall trigger an *ipso facto* clause ban?

The first decision is to consider the relevant procedural framework in a jurisdiction based on the principal decision made in step 1. If the rationale is to protect the restructuring effort of the debtor (only), the regime would only encompass restructuring procedures. The EU preventive restructuring framework is a prime example.

If the rationale for the imposition of constraints is broader and also includes the protection of any going concern of the debtor's business, the *ipso facto* regime would also need to apply to all procedural options in a jurisdiction where the business is continued. The ban would also apply to liquidation proceedings as far as the business continues trading here, probably in order to secure a going-concern liquidation or, where still possible, a plan solution. Only procedures with the sole purpose of a piecemeal liquidation would not need to restrict the use of *ipso facto* rights. In jurisdictions where liquidation is predominantly on a piecemeal basis and therefore the company ceases to trade immediately, such as in the United Kingdom, the inclusion of liquidation may be hard to justify. However, it is not always easy to determine in advance whether a liquidation will be on a going-concern or piecemeal basis. Many jurisdictions feature a uniform liquidation process where businesses enter as a going concern. Here, the protection of the going-concern sale option could support the application of an *ipso facto* regime in liquidation generally.

6.2.2 | Which kind of contracts are affected by an *ipso facto* clause ban?

The rationale adopted in step 1 would also guide the policy decision about the scope of a ban with regard to the types of contracts encompassed by it. Aspects of legal certainty and non-discrimination could mandate a broad scope, including all contracts of the debtor. The specific rationale would, however, only demand a ban that is limited to contracts that are still to be performed ('executory contracts') and also essential to keep the debtor's business alive when proceedings as defined in the previous paragraph are commenced. The EU Directive and the pre-2020 UK legislation include limits to a small number of contracts that are essential for the continuation of the debtor's business.

1. Executory contracts: Connecting the scope of the *ipso facto* ban on enforceability to executory contracts provides the comfort of borrowing the definition of the scope from a concept that is well established in many jurisdictions' insolvency laws, most prominently in the United States,¹³⁴ but also, as explained above, in the United Kingdom and Germany. Such a connection may, however, also complicate things as the relevant insolvency law rules on executory contracts in many jurisdictions contain specific policy choices about how to handle such contracts in insolvency proceedings in order to balance the interests of the estate and the counterparty. These choices might not be in line with those made in the *ipso facto* discussion.

Further, any ambiguity inherent to the local rules on executory contracts is being imported to the *ipso facto* regime as the US experience seems to demonstrate where the close linking of the stay on *ipso facto* clauses with how executory contracts can be treated during bankruptcy proceedings has moved the site of litigation in the United States to whether the contract is executory or not and the case law in this respect is uneven, with some courts finding that contracts are non-executory and allowing *ipso facto* clauses to be enforced and other courts finding them to be executory contracts and thus the clause unenforceable in order to facilitate a reorganization.¹³⁵ Thus, contesting a contract as non-executory has been a path through which to find the bankruptcy default clause enforceable.

2. Essential contracts: The rationale for imposing constraints on *ipso facto* clauses may well justify the policy not encompassing all executory contracts. The EU Directive would require Member States to implement a ban for essential executory contracts only in Article 7(4) while preserving an option to include more. The UK regime, for example, has implemented its *ipso facto* constraints in stages, first focusing on certain essential supply contracts, such as utilities and information technology, and subsequently expanding to include all suppliers, subject to exclusions, but not executory contracts more broadly.

When aiming to adopt such a differentiating regime, the required legal design raises difficult questions as to the definition of which contracts are to be regarded as ‘critical’ or ‘essential’ and who has the task of performing this assessment, leading to potential uncertainty for debtors and creditors.

3. Excluded contracts: Instead (or in addition) to defining essential (executory) contracts, the *ipso facto* regime could principally include all contracts with the debtor and then only exclude an exhaustive and clearly defined list of types of contracts, on specific policy grounds. This policy choice is grounded in a special need for legal certainty, but also (and more often) in the need for a harmonized treatment of such contracts in all jurisdictions globally. Hence, international contracts would often try to set up a bankruptcy-remote set of default rules including *ipso facto* clauses and national lawmakers could find good reason not to interfere. *Ipsso facto* clauses have been a key part of long-term contracting in many industries, most prominently in shipbuilding, licensing, and/or financial contracts. They meet the desire to avoid uncertainty in case of the insolvency of a contractual counterparty to the extent possible, especially in an international contract. Any ban, which may be well balanced under local law policy choices, might collide with such standards and effectively exclude a jurisdiction from participating in standardized international markets.

The UNCITRAL Legislative Guide also observes in this respect that such exceptions to a general override of these clauses can be made for certain types of contracts, such as financial contracts.¹³⁶ As noted in all the jurisdictions discussed in parts II–V, EFC are frequently excluded from bans on enforceability of *ipso facto* clauses for reasons of risks to the financial system and the availability of capital. There can be significant advantages to excluding these contracts, in order to incentivize these creditors continuing to provide capital at a reasonable cost.

However, jurisdictions need to be very clear on the scope of these exemptions and the underlying policy rationale. For example, the US Bankruptcy Code exempts derivatives from the stay on enforceability of *ipso facto* provisions, and the 2005 amendments enhanced this special treatment by adding §561, which specifically preserves the contractual right to terminate,

liquidate, accelerate or offset under a broad range of derivative contracts and master netting agreements.¹³⁷ Several scholars have argued that the scope of exclusions from the *ipso facto* stay provisions for derivatives and other qualified financial contracts has been cast too broadly, with considerable litigation on whether the contract is a qualified financial contract.¹³⁸

An exclusion of financial creditors from the scope of these constraints does also have the consequence of focusing their effect on trade suppliers and others who are often unsecured, and who, absent statutory protections for them, will in many cases lose substantially all the value of their claims. This issue raises questions of unfairness between different classes of creditors of the company and highlights the importance of the law's protection of these creditors, discussed next.

6.3 | Step 3: Clarity in the availability of safeguards for affected counterparties

Once the rationale and the scope of the ban are determined, counterparties of the debtor affected by the regime must also know about the availability of remedies. The next policy question is thus what types of safeguards can be included to mitigate the effects on creditors.

For example, as discussed above, Canada protects creditors by stating that they do not have to offer any further credit, and they can demand COD for the provision of any further goods or services or leased property. Alternatively, the UNCITRAL Legislative Guide observes that one way of dealing with any negative impact of limiting the effectiveness of *ipso facto* clauses is by providing compensation to creditors that can demonstrate they have suffered damage or loss as a result of the contract continuing to be performed after commencement of insolvency proceedings.¹³⁹ In making a policy choice to compensate, legislators will have to consider what is the nature of the claim and what evidence is required to establish that claim; what is the nature of the compensation, the amount that might be available, how the claim or the hardship is assessed or evaluated; whether it is coming out of the assets of the estate, and if so, at what level of priority.

Another safeguard protection that can be considered is a policy that the creditor affected can apply to the court for a determination that prohibitions on termination or acceleration do not apply or apply only to the extent declared by the court, where the applicant satisfies the court that the operation of those subsections would likely cause it significant financial hardship. The issue for the court will be whether such a route is open to individual creditors, and what the precise grounds of hardship or other reason are in order for the court to grant an exception. If a hardship or similar exemption is available to single creditors, such requests are likely to involve weighing the interests of the individual creditor against the interests of the debtor/creditors as a whole, against the backdrop of the policy goals of imposing the constraints in the first place. The greater the level of protection provided, the more the balance swings back in favour of creditors. However, such limited purpose exemptions can give rise to intra-creditor issues, where one group of creditors concludes that treatment of their *ipso facto* clause has been inequitable in comparison with another creditor. These issues are undoubtedly important, but difficult, as the ongoing litigation around this issue in the otherwise relatively settled Canadian *ipso facto* regime demonstrates.

6.4 | Step 4: Transparency about the choices made

Whatever the policy choices, they need to be clearly articulated so that contractual counterparties understand the rationale for setting aside their negotiated arrangements at the point of

insolvency proceedings. These policy choices can also be relevant to creditors' ability to challenge the imposition of *ipso facto* constraints. For example, in regimes that stress a rescue rationale for the imposition of *ipso facto* constraints, creditors making a hardship application to court could seek to argue that the constraints are not justified where a rescue or preservation of the business for the purposes of a sale is not in prospect.

The Canadian system works well on the whole because it is regarded as having achieved a satisfactory balance of multiple creditor and other stakeholder interests. The same cannot be said about the German system where its insolvency law position on *ipso facto* clauses is unclear and yet to be fully determined by case law. The UK reforms illustrate the need to take account of the likely effect on creditor behaviour; for example, is the test for constraint on enforceability of *ipso facto* clauses meeting the technical definition of insolvency or the commencement of an insolvency proceeding? Where, as in the United Kingdom, it is formal insolvency of the company or entry into a specified procedure, rather than actual insolvency, it might incentivize creditors to exercise termination clauses at the first sign of financial distress. The incentive effects will vary from jurisdiction to jurisdiction, but poorly drafted *ipso facto* constraints may risk undermining the very rescue objective they aim to promote. The UNCITRAL *Legislative Guide* recognizes this danger and cautions that where an insolvency law provides that termination clauses can be overridden, creditors may be tempted to take pre-emptive action by terminating the contract on some other ground before insolvency proceedings commence; and such a result may be mitigated by providing that the insolvency representative has the power to reinstate those contracts, provided that both pre- and post-commencement obligations are fulfilled.¹⁴⁰

6.5 | Step 5: Timing of a law reform

The clarity of the actual provisions is critically important to creating certainty, transparency, and predictability for contracting parties well before insolvency and then during the proceedings. The example of jurisdictions such as Canada in which these provisions have been in place for some time suggests that the parties do learn to bargain in the shadow of these provisions and clarity in the structure and ambit of the provisions maximizes the creditors' ability to bargain effectively *ex ante* for the protection they need.

One question is whether the introduction of any such constraints should operate retrospectively. Arguably such changes might be fairer to prospective creditors, who can bargain with these changes to the law in mind as compared with existing creditors who bargained under one regime but now find themselves in another. In the United Kingdom, for example, while the pre-2020 constraints on *ipso facto* clauses were not retrospective,¹⁴¹ the *ipso facto* constraints introduced in 2020 apply retrospectively.¹⁴² This timing is problematic from the point of view of allowing creditors to adjust their position in light of the change in the law, particularly given the significant policy shift that this change represents. It is preferable if such changes are not retrospective.

6.6 | Step 6: Cross-border challenges

Finally, policymakers should consider how their constraints on enforceability of *ipso facto* clauses may interact and/or impact cross-border comity and cooperation. Are the envisioned

constraints even effective in a cross-border setting where the contract is governed by the law of a jurisdiction other than the jurisdiction of the insolvency or restructuring proceeding, or does the law of the other jurisdiction apply? Similarly, if the exemptions for specific contracts, such as financial contracts, are not the same in the jurisdiction of the proceeding and the jurisdiction in which the executory obligations of the contract are being undertaken, what is the policy decision regarding extraterritoriality of the jurisdiction of the proceedings?

There is no substantial harmonization on these issues, and nor is it the purpose of this article to suggest that harmonization is necessary. Although some issues seem common to all jurisdictions (e.g., the exclusion of financial creditors from the effect of any constraints), there are also many differences. Different jurisdictions can and should take account of the different legislative and market conditions within their regimes to fashion the provisions that will work for them. However, this will undoubtedly raise the question of which regime applies in a cross-border case. As part of the *lex fori concursus*, the *ipso facto* ban of the jurisdiction in which main proceedings are commenced would apply in many jurisdictions (see e.g., Article 7(2) lit. e of the European Insolvency Regulation)¹⁴³ unless territorial proceedings were opened in parallel. To avoid such complications, the *ipso facto* ban could instead be governed by the law of the contract, which would require a specific rule in the cross-border insolvency law framework as an exception to the *lex fori* principle in many jurisdictions including the European Union. There is no room in this article to further evaluate these two options or even consider others. We wish to stress nonetheless that any comprehensive *ipso facto* insolvency or restructuring law reform should consider the issue of cross-border effects, parallel proceedings and forum choice.

7 | CONCLUSION

The existence of *ipso facto* clauses raises the issue whether and to what extent they should be given effect during insolvency and/or financial distress related restructuring proceedings. In contract law, the primary rationale for respecting *ipso facto* clauses is the importance of respecting commercial bargains. Moreover, concern has been expressed that an insolvent business delaying the termination of contracts that the debtor is unable to pay will increase existing levels of debt, to the prejudice of all creditors. Such clauses recognize the need for creators of intellectual property and other intangibles to be able to control the use of that property, and recognize that inability to terminate the contract may negatively affect the co-party's business.¹⁴⁴ However, allowing creditors to rely on *ipso facto* clauses can be problematic from an insolvency perspective and such clauses can be regarded as running counter to the public policy of encouraging the restructuring or rehabilitation of financially distressed companies where they can devise a viable business plan that creditors can support in the requisite numbers. There can be a tension between promoting the debtor's financial survival, which may only be possible with the preservation of some key contracts, and the issue of injecting unpredictability and extra cost into commercial dealings by creating a variety of exceptions to general contract rules.¹⁴⁵

Legislators may address such concerns by designing the scope of their *ipso facto* clause law carefully, as regards the circumstances in which the constraints will operate, the nature of those constraints and the types of contracts that will be affected, as well as considering safe harbour exemptions for sensitive types of contracts. Hardship clauses and other forms of creditor protection may further provide necessary relief for individual counterparties in specific circumstances. This article has examined the choices made in this regard by Canadian, United Kingdom, European Union and German legislators.

Although there are a number of common themes that emerge, such as the exclusion of financial creditors from the scope of the provisions, it is clear that different jurisdictions often make quite distinct policy choices regarding the rationale for any constraints on *ipso facto* clauses as well as on the specific nature and scope of the provisions. The range of choices is not per se problematic as long as they are implemented with clarity and transparency, so that debtors and creditors can bargain *ex ante* in the light of any legislative provisions. It is sensible for jurisdictions to take account of their own preferences (debtor-friendly or creditor-friendly), the specific legislative and market-based circumstances that operate, and the extent to which they wish to have regard to regulatory competition or other pressures in making these decisions, and harmonization of these constraints is unlikely to be beneficial although that does raise the need for a clear conflict of law rule to identify the relevant applicable law in cross-border scenarios. Different jurisdictions will find different points of balance between the interests of individual creditors in upholding their freedom of contract and the rights of the debtor and creditors as a whole in preserving the business as a going concern. This article has highlighted the policy choices that need to be considered in designing and implementing any ban on the enforceability of *ipso facto* clauses in order to craft an appropriate balance.

ENDNOTES

- ¹ The recent introduction of constraints on *ipso facto* clauses is also observable in other regimes, see, for example, section 440, Insolvency, Restructuring and Dissolution Act 2018 (Singapore); sections 415D, 434J and 451E, Corporations Act 2001 (Australia), inserted by Treasury Laws Amendment (2017) Enterprise Incentives (No. 2) Act 2017 (Australia); the Dutch restructuring framework introduced in Wet Homologatie Onderhands Akkoord (WHOA).
- ² UNCITRAL, *Legislative Guide on Insolvency Law* (2004) para 114.
- ³ Henry Black (ed), *Black's Law Dictionary* (5th edn) (West Publishing Co. 1979) 743.
- ⁴ *Idem*.
- ⁵ *Sun Indalex Finance, LLC v. United Steelworkers*, 2013 SCC 6; [2013] 1 SCR 271 (SCC), para 1.
- ⁶ Bankruptcy and Insolvency Act, RSC 1985, c B-3, as amended (BIA).
- ⁷ Companies' Creditors Arrangement Act, RSC 1985, c C-36, as amended (CCAA).
- ⁸ 9354-9186 *Québec inc v. Callidus Capital Corp*, 2020 SCC 10, paras 38–52 (*Callidus*). See also Janis Sarra, *Rescue! The Companies' Creditors Arrangement Act* (2nd edn) (Carswell 2013).
- ⁹ Sections 65.1, 66.11 and 84.2(1), BIA; section 34(1), CCAA.
- ¹⁰ Section 2, BIA.
- ¹¹ Section 30, SC 1992, c 27; section 43, SC 2005, c 47; section 92, SC 2007 c 29.
- ¹² *Callidus* (above n 8), para 42, citing Sarra (above n 8), 14 and *Ernst & Young Inc. v. Essar Global Fund Ltd.*, 2017 ONCA 1014, para 103.
- ¹³ See, for example, *Re Doman Industries Ltd.*, 2003 CarswellBC 538; [2003] BCJ No. 562 (BCSC). See also *Call-Net Interim Order*, 20 February 2002, No. 01-CL-4423, para 48 (Ont. SC), which specified that 'no party, including without limitation the Trustee, shall have any rights to terminate, accelerate or treat as accelerated, amend or declare in default any contract or other agreement to which Call-net is a party due to Arrangeco or Call-Net being a party to this proceeding or having made an application to this Court pursuant to s. 192 of the *CBCA*'. See also Anthony Duggan et al., *Canadian Bankruptcy and Insolvency Law: Cases, Text, and Materials* (3rd edn) (Edmond Montgomery 2015) 296.
- ¹⁴ Sarra (above n 8), 53.
- ¹⁵ *Chandos Construction Ltd v. Deloitte Restructuring Inc*, 2020 SCC 25, para 26 (*Chandos*).
- ¹⁶ *Ibid.*, paras 27–28. See the discussion of this judgment on the anti-deprivation rule in Section 2.3.3.

- ¹⁷ An Act to Establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts, SC 2005, Chapter 47, Royal Assent November 25, 2005 (SC 2005, c 47); Bill C-62, An Act to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005, Royal Assent December 14, 2007 (SC 2007 c 29).
- ¹⁸ *Ramgotra (Trustee of) v. North American Life Assurance Co.* [1996] 1 SCR 325 (SCC); *Re Lalonde* (1952), 32 CBR 191 (SCC).
- ¹⁹ Section 65.1(1), BIA.
- ²⁰ *Ibid.*, section 2. An insolvent person is defined as a person who is not bankrupt and who resides, carries on business or has property in Canada, whose liabilities to creditors provable as claims are CAD 1,000 and who is for any reason unable to meet their obligations as they generally become due, has ceased paying current obligations in the ordinary course of business as they generally become due, or the aggregate of whose property is not, at a fair valuation, sufficient, or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all their obligations, due and accruing due.
- ²¹ *Ibid.*, section 65.1(2).
- ²² *Ibid.*, section 65.1(3).
- ²³ *Ibid.*, section 65.1(5).
- ²⁴ *Ibid.*, section 65.1(1).
- ²⁵ Lloyd Houlden, Geoffrey Morawetz and Janis Sarra, *Annotated Bankruptcy and Insolvency Act, 2020-2021* (Carswell 2021) 297.
- ²⁶ Sections 65.11 to 66, BIA.
- ²⁷ *Ibid.*, sections 66.34 and 84.2. The provisions also apply to consumer debtors.
- ²⁸ *Ibid.*, section 84.2. Section 84.2, BIA prevents a party to a contract from terminating or amending a contract or claiming an accelerated payment or forfeiture of the term under any agreement, including a security agreement, with a bankrupt individual by reason only of the individual's bankruptcy or insolvency.
- ²⁹ Report of the Standing Senate Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden, A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (November 2003) <<https://www.iiiglobal.org/sites/default/files/sharingtheburdenareviewoflegislation.pdf>>.
- ³⁰ Sections 34(1)–(3), CCAA.
- ³¹ *Ibid.*, section 34(2).
- ³² *Ibid.*, section 34(3).
- ³³ *Ibid.*, section 34(5).
- ³⁴ Section 65.1(4), BIA.
- ³⁵ *Re 728835 Ontario Ltd.* (1998), 3 CBR (4th) 211 (Ont. Gen. Div. [Commercial List]); affirmed (1998), 3 CBR (4th) 214, 111 OAC 155 (Ont. CA).
- ³⁶ Section 65.1(6), BIA.
- ³⁷ *Idem.*
- ³⁸ UNCITRAL, *Legislative Guide on Insolvency Law* (above n 2).
- ³⁹ *Toronto-Dominion Bank v. Ty (Canada) Inc* (2003), 42 CBR (4th) 142, 2003 CarswellOnt 1371 (Ont. SCJ).
- ⁴⁰ *Idem.*
- ⁴¹ *HSBC Bank Canada v. Tri-Tec Industries Ltd.* (2006), 2006 CarswellOnt 3174, 22 CBR (5th) 120 (Ont. SCJ).
- ⁴² *Re Cosgrove-Moore Bindery Services Ltd.* (2000), 2000 CarswellOnt 1561, 17 CBR (4th) 205, 48 OR (3d) 540 (Ont. SCJ).
- ⁴³ Section 34(4), CCAA.
- ⁴⁴ *Ibid.*, section 34(4).

- ⁴⁵ Ibid., section 34(6).
- ⁴⁶ Philippe Bélanger and Sylvain Rigaud, *La réforme en matière d'insolvabilité: nouveautés et codification de pratiques existantes* (Yvon Blais 2009) 70–71.
- ⁴⁷ Idem, discussing section 84.2(6), BIA.
- ⁴⁸ Ibid., 74.
- ⁴⁹ Section 65.1(7), BIA.
- ⁵⁰ Section 2, Eligible Financial Contract General Rules (Bankruptcy and Insolvency Act), SOR/2007-256, as amended, defines eligible financial contracts. Derivatives agreement means a financial agreement whose obligations are derived from, referenced to, or based on, one or more underlying reference items such as interest rates, indices, currencies, commodities, securities or other ownership interests, credit or guarantee obligations, debt securities, climatic variables, bandwidth, freight rates, emission rights, real property indices and inflation or other macroeconomic data and includes a contract for differences or a swap, including a total return swap, price return swap, default swap or basis swap; a futures agreement; a cap, collar, floor or spread; an option; and a spot or forward.
- ⁵¹ Ibid., section 1. It also includes: an agreement to (i) borrow or lend securities or commodities, including an agreement to transfer securities or commodities under which the borrower may repay the loan with other securities or commodities, cash or cash equivalents, (ii) clear or settle securities, futures, options or derivatives transactions, or (iii) act as a depository for securities; (c) a repurchase, reverse repurchase or buy–sell back agreement with respect to securities or commodities; (d) a margin loan in so far as it is in respect of a securities account or futures account maintained by a financial intermediary; ... (h) a guarantee of, or an indemnity or reimbursement obligation with respect to, the liabilities under an agreement referred to in any of paragraphs (a) to (g); and (i) an agreement relating to financial collateral, including any form of security or security interest in collateral and a title transfer credit support agreement, with respect to an agreement referred to in any of paragraphs (a) to (h).
- ⁵² Section 65.1(7), BIA.
- ⁵³ Ibid., section 65.1(9).
- ⁵⁴ Ibid., section 65.1(10).
- ⁵⁵ See the discussion in Andrew Kent et al., 'Eligible Financial Contracts vs. Insolvency: Round II', in Janis Sarra (ed), *Annual Review of Insolvency Law 2007* (Carswell 2008) 1–20.
- ⁵⁶ Ibid., at 3.
- ⁵⁷ Margaret Grottenthaler and Philip Henderson, *The Law of Financial Derivatives in Canada* (loose-leaf) (Thomson Canada Limited, 2003), 5.1; Ezgi Kaya, *Derivatives Contracts in Insolvency* (Insolvency Institute of Canada) <<http://www.insolvency.ca/docs/writingAwards/2006/Derivatives%20Contracts%20in%20Insolvency.pdf>>; Basel Committee on Banking Supervision, *Consultative Document – The New Basel Capital Accord* (Bank for International Settlement) <<http://www.bis.org/bcbs/bcbscp3.pdf>>.
- ⁵⁸ Section 34(7), CCAA.
- ⁵⁹ Insolvency Institute of Canada, *Report of the Task Force on Derivatives* (2013).
- ⁶⁰ Interview with senior policy advisor, Corporations Canada, 2 April 2021, on file with authors.
- ⁶¹ *Chandos* (above n 15), paras 1, 30. In *Chandos*, a general construction contractor entered into a construction subcontract with Capital Steel Inc., which provided that Capital Steel would pay Chandos 10% of the subcontract price as a fee for the inconvenience or for monitoring the work in the event of Capital Steel's bankruptcy. When Capital Steel filed an assignment in bankruptcy prior to completing its subcontract, Chandos argued it was entitled to set off the costs it had incurred to complete it and to set off 10% of the subcontract price. The application judge found the provision to be a valid liquidated damages clause, the Court of Appeal reversed the decision, and the SCC dismissed a further appeal. See also *Alberta (Attorney General) v. Moloney*, 2015 SCC 51; [2015] 3 SCR 327, para 33; *Husky Oil Operations Ltd. v. Minister of National Revenue*, 1995 CanLII 69 (SCC); [1995] 3 SCR 453, paras 7–9.
- ⁶² Ibid., para 31. The SCC held that 'Parliament's actions are better understood as gradually codifying limited parts of the common law rather than seeking to oust all related common law'. Ibid., paras 27–28, citing *Bill*

C-22: *Clause by clause Analysis*, clause 87, section 65.1 and clause 89, section 66.34, reproduced in the Attorney General of Canada's book of authorities, at Tab 4; Standing Senate Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (2003), 74–75. The SCC held that Parliament is presumed to intend not to change the existing common law unless it does so clearly and unambiguously: *ibid.*, para 29.

⁶³ *Ibid.*, para 31.

⁶⁴ *Ibid.*, para 24.

⁶⁵ *Ibid.*, para 35.

⁶⁶ *Ibid.*, paras 34–37.

⁶⁷ *Ibid.*, para 38. The SCC held that the clause requiring Capital Steel to forfeit 10% of the subcontract price was a direct violation of the rule that cannot be rescued by the law of set-off, as set-off only applies to enforceable debts or claims: *ibid.*, paras 43–44.

⁶⁸ *Ibid.*, para 30, discussing section 71, BIA.

⁶⁹ *Idem.*

⁷⁰ *Ibid.*, para 40. An example of commercial parties protecting themselves is illustrated in the Ontario Court of Appeal judgment in *Re 7636156 Canada Inc.* 2020 ONCA 681, which dealt with the right of a commercial landlord to draw on a letter of credit (LOC), posted as security by its tenant, following the disclaimer of the lease by the tenant's trustee in bankruptcy. In accordance with the terms of the lease, the tenant arranged for an irrevocable standby LOC issued by a bank in the amount of CAD 2.5 million in favour of the landlord as beneficiary. The Ontario Court of Appeal held that a 'standby letter of credit is a performance-securing mechanism in that it constitutes an obligation of the issuer to the beneficiary to make payment on account of any default by the applicant customer in the performance of an obligation upon certification by the beneficiary that the applicant has failed to fulfil its obligations to the beneficiary': *Ibid.*, paras 34, 52, 107.

⁷¹ See, for example, *Printing and Numerical Registering Co. v. Sampson* (1874-1875) LR 19 Eq 462, 465 (per Sir George Jessel MR).

⁷² See *British Eagle International Airlines Ltd v. Cie Nationale Air France* [1975] 1 WLR 758.

⁷³ See *Belmont Park Investments Pty Ltd. v. BNY Corporate Trustee Services Ltd* [2012] 1 AC 383 (*Belmont Park*).

⁷⁴ *Ibid.*, [103] (per Lord Collins).

⁷⁵ *Ibid.*, [104].

⁷⁶ For example, *Re Pan Ocean Co Ltd* [2014] Bus LR 1041. More difficult was a provision for the modification for contract terms, rather than for the termination of a contract.

⁷⁷ Sections 233 and 233A, Insolvency Act 1986, the latter introduced by the Insolvency (Protection of Essential Supplies) Order 2015 (SI 2015/989).

⁷⁸ *Ibid.*, section 233(2), which, as a condition of continuing to supply, entitles the supplier to require the insolvency office holder personally to guarantee payment.

⁷⁹ Section 14 and Schedule 12, Corporate Insolvency and Governance Act 2020 (CIGA).

⁸⁰ See Part 26A, Companies Act 2006, discussed in Jennifer Payne, *Schemes of Arrangement: Theory, Practice and Operation* (2nd edn) (CUP 2021) ch 5.8.

⁸¹ See Schedule A1, Insolvency Act 1986, discussed in Jennifer Payne, 'An Assessment of the UK Restructuring Moratorium' (2021) *LMCLQ* 454.

⁸² *Ibid.*, section 233B.

⁸³ Whilst the *ipso facto* provisions are a permanent change to the UK's insolvency regime, CIGA contained a temporary exclusion for small suppliers, which effectively permitted such small suppliers to terminate contracts for the supply of goods or services with companies which enter into a 'relevant insolvency procedure': section 15, CIGA, as amended.

⁸⁴ Insolvency Service, *A Review of the Corporate Insolvency Framework: A Consultation on Options for Reform* (May 2016); Insolvency Service, *Summary of Responses – A Review of the Corporate Insolvency framework* (September 2016).

- ⁸⁵ Insolvency Service, *Consultation on Insolvency and Corporate Governance* (March 2018); Insolvency Service, *Consultation on Insolvency and Corporate Governance: Government Response* (August 2018).
- ⁸⁶ These are produced annually, see, for example, World Bank Group, *Doing Business 2020: Comparing Business Regulation in 190 Economies*. For discussion on the background to the Government Proposals in 2018, see Sandra Frisby, 'Of rights and rescue: a curious confluence' (2020) *Journal of Corporate Law Studies* 39.
- ⁸⁷ Explanatory Notes accompanying CIGA, para 33.
- ⁸⁸ Section 233B(1), Insolvency Act 1986.
- ⁸⁹ *Ibid.*, section 233B(2) (the Government retains powers to amend this list: section 233C). Schemes of arrangement are not included on this list, despite their broad similarity to restructuring plans.
- ⁹⁰ Notably, winding up is not included in the list of relevant procedures for section 233A purposes.
- ⁹¹ See *Belmont Park* (above n 73), [149] (per Lord Mance).
- ⁹² See section 233B(3)(4), Insolvency Act 1986.
- ⁹³ *Ibid.*, section 233B(3).
- ⁹⁴ *Idem.*
- ⁹⁵ *Ibid.*, section 233B(5).
- ⁹⁶ *Ibid.*, section 233B(4). See also section 233B(8).
- ⁹⁷ See 11 USC §365(e). The regime in Singapore is also broader than the UK regime: section 440, Insolvency, Restructuring and Dissolution Act 2018 (Singapore). See also Article 7.4, Directive (EU) 2019/1023 (EU Restructuring Directive/Directive), discussed in Part V.B.
- ⁹⁸ Suppliers may therefore be left rather exposed; further protection to the supplier would be available if the officeholder ensures that the costs of any supplies during the process are expenses in any liquidation or administration and paid in priority to unsecured and floating charge claims.
- ⁹⁹ Section 233B(5)(a)(b), Insolvency Act 1986.
- ¹⁰⁰ *Ibid.*, section 233B(5)(c).
- ¹⁰¹ *Ibid.*, section 233B(6). A similar hardship provision is to be found in section 440(4), Insolvency, Restructuring and Dissolution Act 2018 (Singapore).
- ¹⁰² See *Re Atlantic Computer Systems plc* [1990] BCC 859, 880 (per Nicholls LJ).
- ¹⁰³ See House of Commons Library Briefing Paper, No. 8922, 1 June 2020, 30.
- ¹⁰⁴ Notably, section 233B does not provide for circumstances in which an office holder does not want to continue taking supply of certain goods or services, unlike its Chapter 11 counterpart (11 USC §365). Under section 233B, suppliers contracted to supply goods or services are under a statutory duty to continue performing their contractual obligations, regardless of the office holder's intentions or ability to pay for the goods or services. As there is no requirement for the company to assume or reject contracts within set time periods, suppliers could be left with a period of uncertainty where they cannot terminate.
- ¹⁰⁵ See Schedule 12, CIGA.
- ¹⁰⁶ There remains some uncertainty about the precise extent of this exclusion and whether it applies to all loan documentation. In particular, on a strict reading of the new Schedule 4ZZA, intercreditor agreements would not be excluded from the prohibition; whether intercreditor agreements are agreements for the supply of services is unclear.
- ¹⁰⁷ A short-term exclusion was also inserted into the Act to deal with small suppliers in the COVID period: sections 15, 19, CIGA.
- ¹⁰⁸ Above n 97.
- ¹⁰⁹ See section 17, Konkursordnung (KO) (German bankruptcy code, in force from 1877 to 1999). See also section 53, Vergleichsordnung (VglO) (German composition code in force from 1927 to 1999).
- ¹¹⁰ See BGH, 26.9.1985, BGHZ 96, 34 = NJW 1986, 255.
- ¹¹¹ 'Kommission für Insolvenzrecht'.

- ¹¹² LS 2.4.1.11 of the Commission's First Report, 1985.
- ¹¹³ See BT-Drs. 12/2443, 30.
- ¹¹⁴ See BT-Drs. 12/7302, 170.
- ¹¹⁵ See BGH, 15.11.2012, BGHZ 195, 348 = NJW 2013, 1159.
- ¹¹⁶ *Ibid.*, para 9.
- ¹¹⁷ *Ibid.*, para 13.
- ¹¹⁸ *Ibid.*, para 19.
- ¹¹⁹ *Ibid.*, para 16.
- ¹²⁰ See BGH, 26.11.2003, NZI 2004, 144.
- ¹²¹ See BGH, 7.4.2016, BGHZ 210, 1 = NJW 2016, 1945, para 53.
- ¹²² See BGH, 11.11.1993, BGHZ 124, 76 = NJW 1994, 449.
- ¹²³ Above n 97. It has its origins in a 2014 Recommendation: European Commission, Recommendation on a new approach to business failure and insolvency, 12 March 2014 C(2014) 1500. For discussion see Horst Eidenmüller and Kristin van Zwieten, 'Restructuring the European Business Enterprise: The EU Commission Recommendation on a New Approach to Business Failure and Insolvency' (2015) 16 *EBOR* 625.
- ¹²⁴ For discussion, see Gerard McCormack, 'Corporate Restructuring Law - a Second Chance for Europe?' (2017) 42(4) *European Law Review* 561.
- ¹²⁵ Recital 24, EU Restructuring Directive.
- ¹²⁶ *Ibid.*, recital 40.
- ¹²⁷ *Ibid.*, recital 41 lists certain examples of essential supply contracts to which this would be of particular importance such as, supply of gas, electricity, water, telecommunication and card payment services.
- ¹²⁸ *Idem.*
- ¹²⁹ *Ibid.*, Article 2(5).
- ¹³⁰ See Gesetz zur Fortentwicklung des Sanierungs- und Insolvenzrechts (SanInsFoG), BGBl. 220 I, 3256.
- ¹³¹ See section 22(2), Restrukturierungsordnung (ReO) (Austrian draft implementation bill).
- ¹³² UNCITRAL, *Legislative Guide on Insolvency Law* (above n 2), para 116.
- ¹³³ *Ibid.*, para 117.
- ¹³⁴ 11 USC § 363(l); § 541(c)(1)(B); and § 365(e)(1), US Bankruptcy Code. It also invalidates provisions in agreements, transfer instruments and applicable non-bankruptcy law that would otherwise operate to prevent a debtor's property from becoming property of its bankruptcy estate based on the debtor's insolvency or financial condition or on a bankruptcy filing.
- ¹³⁵ *In Re General Growth Properties, Inc.*, 451 B.R. 323 (Bankr. SDNY 2011), in which *In Re General Growth Properties, Inc.*, the Bankruptcy Court that 'although *ipso facto* clauses are unenforceable under certain circumstances not applicable here, such clauses are not per se invalid in the Second Circuit except where contained in an executory contract or unexpired lease'. See also *US Bank Trust National Ass'n v. American Airlines, Inc. (In re AMR Corp)* 485 B.R. 279, 296-97 (Bankr. SDNY 2013). Paul Rubin, 'Not every *ipso facto* clause is Unenforceable in Bankruptcy' (2013) 32(7) *ABI Journal* 12, 13, citing *20 Bayard Views LLC v. W Financial Fund LP (In re 20 Bayard Views LLC)*, Case No. 09-50723 (Bankr. EDNY August 11, 2010) (unpublished oral decision). *Katzenstein v. VIII SV5556 Lender LLC (In re Saint Vincent's Catholic Medical Centers of New York)*, 440 B.R. 587 (Bankr. SDNY 2010). *In re SAINT VINCENT'S CATHOLIC MEDICAL CENTERS OF NEW YORK*, et al., Debtors. Michael E. Katzenstein, in his capacity As the MedMal Trust Monitor, Plaintiff, v. VIII SV5556 Lender, LLC, Defendant. United States Bankruptcy Court, S.D. New York. November 12, 2010. In *Riggs Nat'l Bank v. Perry*, 729 F. 2d 982, 984 (4th Cir. 1984); and William Burnett, 'Prepetition Waivers of the Automatic Stay: Automatic Enforcement Equals Automatic Trouble' (1996) 5 *J. Bankr. L. and Prac.* 257, 283, the Fourth Circuit of Appeals affirmed that enforcement of a bankruptcy default clause would intrude upon the Bankruptcy Code's clear purpose of creating a way by which debtors may obtain a fresh start toward reorganization of their financial obligations.

- ¹³⁶ UNCITRAL, *Legislative Guide on Insolvency Law* (above n 2), paras 118, 208–215.
- ¹³⁷ See, for example, Charles Mooney Jr., ‘The Bankruptcy Code’s Safe Harbors for Settlement Payments and Securities Contracts: When Is Safe Too Safe’ (2014) 49 *Tex. Int’l. L. J.* 245.
- ¹³⁸ John Pottow, ‘New approach to executory contracts’ (2018) 96(7) *Texas Law Review* 1,437–1472. See, for example, the articles cited in Mooney (above n 137): Bryan Faubus, ‘Narrowing the Bankruptcy Safe Harbor for Derivatives to Combat Systemic Risk’ (2010) 59 *Duke L.J.* 801; Stephen Lubben, ‘Derivatives and Bankruptcy: The Flawed Case for Special Treatment’ (2009) 12 *U. Pa. J. Bus. L.* 61; Mark Roe, ‘The Derivatives Market’s Payment Priorities as Financial Crisis Accelerator’ (2011) 63 *Stan. L. Rev.* 539; David Skeel, Jr. and Thomas Jackson, ‘Transaction Consistency and the New Finance in Bankruptcy’ (2012) 112 *Colum. L. Rev.* 152; Richard Squire, ‘Shareholder Opportunism in a World of Risky Debt’ (2010) 123 *Harv. L. Rev.* 1151; Michael Weiss, ‘Using Derivatives to Create Bankruptcy Proof Loans’ (2010) 30 *Cal. Bankr.*
- ¹³⁹ UNCITRAL, *Legislative Guide on Insolvency Law* (above n 2), paras 118, 208–215.
- ¹⁴⁰ *Ibid.*, para 119.
- ¹⁴¹ Section 233A, Insolvency Act 1986.
- ¹⁴² *Ibid.*, section 233B.
- ¹⁴³ Regulation (EU) No. 2015/848 of 20 May 2015.
- ¹⁴⁴ UNCITRAL, *Legislative Guide on Insolvency Law* (above n 2), para 119.
- ¹⁴⁵ *Ibid.*, para 117.

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