9 When Insolvency meets Freedom of Contract: Ipso Facto and Cross-default Clauses■

9.1 Introduction

This chapter provides a general introduction to ipso facto and cross-default clauses, which are common in commercial practice, especially in loan and bond documentation, repurchase, and securities lending agreements. They also typically implicate several group entities. This is why their analysis and treatment in insolvency are necessary to comprehensively cover the subject of intra-group financing. Both types of clauses increase the power of a counterparty (creditor), as they grant the creditor the right to terminate, accelerate, or amend a contract with the debtor upon a specified event, often termed as an "event of default". This is akin to other contractual covenants granting a creditor additional means to control and police the debtor. Section 9.2. offers examples of ipso-facto and cross-default clauses and discusses their rationale.

When the contractually agreed triggering event relates to the debtor's (bad) financial situation, insolvency filing, commencement of insolvency proceedings, appointment of an IP, or a similar event, this clause will be referred to as an ipso facto clause, Latin for "by the fact itself". This indicates that termination and acceleration rights do not result from the debtor's default on a substantive obligation (e.g. payment and delivery obligations, provision of collateral) but follow from the very fact of occurrence of an insolvency-related event. Given that ipso facto clauses have an effect on reorganisation and could harm unsecured creditors, many legal systems, including those studied in this book, restrict freedom of contract and limit the effectiveness of ipso facto clauses in insolvency. The scope of such limitations is examined in section 9.3.

Cross-default clauses are similar to ipso facto clauses, as both grant a counterparty certain rights or options. Nevertheless, this book distinguishes them from ipso facto clauses, because they require a breach of a contract or failure to perform an obligation. The specificity of a cross-default is that such breach or failure on one obligation leads to a default on another obligation.

■ This chapter builds upon the following previously published work by the author:
– I. Kokorin, Promotion of group restructuring and cross-entity liability arrangements, Journal of Corporate Law Studies, Vol. 21, 2021, pp. 557-593.

These obligations usually arise under different contracts concluded with the same creditor, another creditor, or even another group entity. Yet, just like ipso facto clauses, they can drive a borrower into insolvency by allowing acceleration or termination of a contract at the first signs of financial troubles. Hence, they contribute to creditor risk control and risk mitigation. That being said, cross-default clauses are treated differently in law. Unlike ipso facto clauses, they are generally held to be valid and enforceable. However, this does not mean that they are not affected by insolvency law. Section 9.4. shows how national law regimes deal with default-triggered clauses.

Section 9.5. summarises the ex post effects of ipso facto and cross-default clauses, specifically when an event of default relates to another group company and not to the direct counterparty. We argue that, like guarantees, such cross-entity or intercompany ipso facto and cross-default clauses link separate group companies and increase the correlation within an enterprise group, thereby producing a domino-like effect and weakening the insulation offered by corporate shields. This begs the question whether and under what circumstances restricting the ability of parties to contract is desirable. Section 9.6. concludes.

9.2 Ipso Facto and Cross-Default Clauses: Definition and Rationale

9.2.1 Ipso facto clauses

Ipso facto clauses are contractual provisions that grant a creditor the right to terminate, accelerate, or amend a contract, or to refuse performance under it, if there is an event of default. This event should be linked to the debtor's application for commencement or commencement of insolvency proceedings, appointment of an IP, financial distress, or even indicators that the debtor is in a weak financial position.[1] The operation of ipso facto clauses might be extended to encompass several group entities that are not the creditor's counterparties. For instance, a clause could stipulate that the creditor is entitled to suspend contractual performance or to terminate or amend the contract with a debtor-direct counterparty if any company with the debtor's group initiates an insolvency proceeding.

An example of such a cross-entity ipso facto clause, linking the event of default to an insolvency filing or similar actions related to the debtor or "any Material Subsidiary" is provided below. It relates to the securities

1 UNCITRAL Legislative Guide, Part two, Ch. II, para. 114.

issued by Oi S.A., the group's parent company, and guaranteed by its subsidiaries – a common group financing structure (see section 1.1.3.).

Events of Default. An Event of Default occurs if:

(6) the Company or any Material Subsidiary commences a voluntary case or other proceeding seeking liquidation, judicial or extrajudicial reorganization or other relief with respect to itself or its Indebtedness under any bankruptcy, insolvency or other similar law now or hereafter in effect, or seek the appointment of a trustee, receiver, judicial administrator (*administrador judicial*), liquidator, custodian or other similar official of it or any substantial part of its property, or consents to any such relief or to the appointment of or taking possession by any such official in an involuntary case or other proceeding commenced against it, or makes a general assignment or conveyance for the benefit of creditors;

(7) a court of competent jurisdiction enters an order or decree against the Company or any Material Subsidiary for (a) liquidation, reorganization or other relief with respect to it or its Indebtedness under any bankruptcy, insolvency or other similar law now or hereafter in effect or (b) the appointment of a trustee, receiver, judicial administrator (*administrador judicial*), liquidator, custodian or other similar official of it or any substantial part of its property; *provided* that such order or decree shall remain undismissed and unstayed for a period of 90 calendar days;[2]

The examples of ipso facto clauses can also be found in the Loan Market Association (LMA) documentation, including the Multicurrency Term and Revolving Facilities Agreement. This Agreement refers to both the financial situation of the debtor or its group members, initiation of negotiations with creditors, and taking steps towards reorganisation as an Event of Default:

23.6 **Insolvency**

(a) A member of the Group[3]:
   (i) is unable or admits inability to pay its debts as they fall due;
   (ii) suspends making payments on any of its debts; or
   (iii) by reason of actual or anticipated financial difficulties, commences negotiations with one or more of its creditors (excluding any Finance Party in its capacity as such) with a view to rescheduling any of its indebtedness. […]

2 Indenture, 10.000%/12.000% Senior PIK Toggle Notes due 2025, Dated as of July 27, 2018 <https://www.sec.gov/Archives/edgar/data/1160846/000119312518265177/d517628dex42.htm> (accessed 15 July 2023).

3 Under the LMA Multicurrency Term and Revolving Facilities Agreement, "Group" is defined as "the Company and its Subsidiaries for the time being".

> 23.7 **Insolvency proceedings**
> Any corporate action, legal proceedings or other procedure or step is taken in relation to:
> (a) the suspension of payments, a moratorium of any indebtedness, winding-up, dissolution, administration or reorganisation (by way of voluntary arrangement, scheme of arrangement or otherwise) of any member of the Group other than a solvent liquidation or reorganisation of any member of the Group which is not an Obligor;
> (b) a composition, compromise, assignment or arrangement with any creditor of any member of the Group; […]

According to Wood, the goal of ipso facto clauses is "to introduce predictability as to whether a party may terminate without having to rely on vague notions of contract breach or anticipatory repudiation."[4] Terminating a contract in a situation of the debtor's financial distress can reduce the risk of prospective (potential) non-performance. Since the debtor's or its group member's financial distress, reorganisation attempt, negotiations with creditors over debt restructuring, and other similar events or actions often indicate increased risks for the creditor, the argument goes that the creditor should be able to rely on a contractual clause to pull out of the deal by terminating or accelerating the contact. In other words, insolvency-related events are used as a proxy for evidence of increased credit risk.

Di Gennaro and Goldstein note the policing function of ipso facto clauses and compare them to financial or restrictive covenants in loan agreements, such as restrictions on debt levels and minimum cash flows and net assets. Both seek to deter the debtor from engaging in excessively risky or opportunistic behaviour by creating a threat of contract termination or acceleration, whether automatic or not.[5] This prophylactic role of ipso facto clauses was also mentioned by Che and Schwartz, who argue that such clauses are socially desirable because they improve managers' incentives to avoid financial distress and allow a solvent firm to exit from bad (unproductive) projects and avoid expectation damages.[6] To the extent that ipso facto clauses promote risk mitigation and give additional means of control to a creditor, they can reduce the agency costs of debt.

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4 P. Wood, Principles of International Insolvency, 2nd edn, Sweet & Maxwell, 2007, para. 16-025. Wood argues at para. 16-026 that the "freeze or stay on self-help termination is unquestionably one of the most draconian and controversial of all the stays, because of the massive impact on transactions."

5 M.J. Di Gennaro, H.J. Goldstein, Can Ipso Facto Clauses Resolve the Discharge Debate? An Economic Approach to Novated Fraud Debt in Bankruptcy, DePaul Business and Commercial Law Journal, Vol. 1, 2003, p. 435. Jackson refutes this argument by pointing out that the actual cost is borne by unsecured creditors and not the debtor or its shareholders. T.H. Jackson, The Logic and Limits of Bankruptcy Law, Beard Books, 2001, pp. 42-43.

6 Y-K. Che, A. Schwartz, Section 365, Mandatory Bankruptcy Rules and Inefficient Continuance, Journal of Law, Economics, & Organization, Vol. 15, 1999, pp. 441-467.

9.2.2 Cross-default clauses

According to Black's Law Dictionary, a cross-default clause is a "contractual provision under which default on one debt obligation triggers default on another obligation."[7] Cross-default clauses are commonly seen in debt financing documents, such as syndicated loan and bond contracts.[8] They are distinct from simple defaults as cross-defaults refer to separate obligations or contracts, often concluded between different parties.[9] In a common group scenario, a default on the obligation of one group entity may automatically trigger a default on the obligation of an affiliated entity, even though, apart from a cross-default, the borrower may have met all of its own obligations to the particular lender.[10] The examples below refer to the performance by the Borrower, and "any Material Subsidiary", or "any member of the Group".

The above-mentioned LMA Multicurrency Term and Revolving Facilities Agreement contains the following description of a cross-default:

> 23.5 **Cross default**
> (a) Any Financial Indebtedness[11] of any member of the Group is not paid when due nor within any originally applicable grace period.
> (b) Any Financial Indebtedness of any member of the Group is declared to be or otherwise becomes due and payable prior to its specified maturity as a result of an event of default (however described). […]

Another example of a cross-default provision is the following clause, included in the USD 750 million unsecured credit facility agreement, entered into between Darden Restaurants Inc. and a group of lenders:

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7 B.A. Garner (ed), Black's Law Dictionary, 8th edn, Thomson West, 2004, p. 405.

8 See N. Li, Y. Lou, F.P. Vasvari, Default clauses in debt contracts, Review of Accounting Studies, Vol. 20, 2015, pp. 1596-1637; J. Gruber, Cross-default clauses in finance contracts, International Business Law Journal, 5, 1997, pp. 591-603; P. Wood, Principles of International Insolvency, 2nd edn, Sweet & Maxwell, 2007, para. 21-006, noting that cross-default clauses are standard in bonds, although they tend to be less comprehensive compared to those in bank credit agreements.

9 Gullifer and Payne consider cross-defaults "non-breach events", because the debtor does not directly breach the contract that is terminated. L. Gullifer and J. Payne, Corporate Finance Law: Principles and Policy, 3rd edn, Hart Publishing, 2020, p. 223; E. Ferran and L.C. Ho, Principles of Corporate Finance Law, 2nd edn, OUP, 2014, p. 294.

10 A.J. Casey, The New Corporate Web: Tailored Entity Partitions and Creditors' Selective Enforcement, The Yale Law Journal, Vol. 124, 2015, p. 2689, explaining that the "inter-entity cross default will cause a loan to one entity to be in default whenever an affiliated entity defaults on a debt obligation."

11 "Financial Indebtedness" means any indebtedness for or in respect of, inter alia, moneys borrowed, any amount raised by acceptance under any acceptance credit facility, any amount raised pursuant to any note purchase facility or the issue of bonds, notes or debentures, etc.

> Cross-Default. The Borrower or any Material Subsidiary (i) fails to make any payment when due (whether by scheduled maturity, required prepayment, acceleration, demand, or otherwise) in respect of any Material Indebtedness, or (ii) fails to observe or perform any other agreement or condition relating to any Material Indebtedness, or any other event occurs, the effect of which default or other event is to cause or to permit the holder or holders of such Material Indebtedness to cause, with the giving of notice if required, such Material Indebtedness to become due prior to its stated maturity; […][12]

In this book, we distinguish between ipso facto and cross-default clauses, even though in practice such a distinction may not be clear-cut. Unlike insolvency-triggered ipso facto clauses, cross-default clauses are tied to non-performance of an obligation or any other form of "misbehaviour" or a breach of a contract (e.g. failure to pay amounts due), whether by a direct counterparty or by another person. Cross-default arrangements are similar to cross-guarantees in the sense that both require some form of default. Indeed, cross-guarantees might be coupled with cross-default provisions.[13] That being said, the rationale and effect of intercompany cross-defaults are quite distinct from group guarantees. The main difference is that cross-default clauses do not grant a creditor access to asset pools of separate companies. Rather, they seek to discipline the debtor, deter breaches, and produce additional monitoring benefits because creditors can better calculate and control risks related to the group's operations.[14] Even though monitoring costs are not fully eliminated,[15] they are reduced. A default by one group entity sends a signal to the creditor that the whole group may be in trouble. In anticipation of financial problems, a cross-default provision entitles the creditor to refuse future performance (e.g. to stop continuous lending under the revolving credit facility) or accelerate its existing claims. In other words, this creditor does not need to wait for its direct counterparty to default before enforcing its claim. In this way, cross-defaults permit the

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12 Darden Restaurants $750,000,000 Credit Agreement dated 20 September 2007 <https://www.sec.gov/Archives/edgar/data/940944/000119312507205607/dex101.htm> (accessed 15 July 2023).

13 A.J. Casey, The New Corporate Web: Tailored Entity Partitions and Creditors' Selective Enforcement, The Yale Law Journal, Vol. 124, 2015, p. 2680.

14 R. Youard, Default in International Loan Agreements – Part 2, Journal of Business Law, 1986, p. 385, explaining that lenders want a "cross-default clause to be wide enough to give early warning of a wider range of situations than may be strictly necessary, simply because it is difficult to predict the future with accuracy and lenders want to be in a position to make their own decision as to whether the event in question is in fact the tip of the iceberg."

15 K. Clark, A. Taylor, Events of Default in Eurocurrency Loan Agreements, International Financial Law Review, Vol. 1, 1982, p. 13, noting that in practice usefulness of cross-default clauses "may be curtailed by the standards of secrecy which banks are accustomed and expected to maintain." One bank might be unaware of a cross-defaulting event. Arguably, monitoring intercompany cross-defaults is even more difficult. Cross-entity monitoring is equally problematic for bonds, as bond financing could lack centralised supervision and control over the issuer or its group entities.

withdrawal of investment at the first sign of financial troubles. The same reasoning was mentioned before with respect to ipso-facto clauses.

Following a cross-default, the threat of contract termination or acceleration might be used to force a contract renegotiation for the benefit of the creditor.[16] This forced renegotiation could concern the way the debtor or the wider enterprise group is managed or doing business (e.g. cost-cutting, sale of assets), thereby giving the creditor an important governance role when the debtor experiences financial difficulties. In sum, cross-default clauses are conducive to risk mitigation, promotion of collection and enhancement of creditor's governance.[17] They seek to improve creditor oversight and may to some extent counteract the creditor disengagement caused by cross-guarantees.

9.3 Enforceability of Ipso Facto Clauses

9.3.1 The UK: contracts for supply of goods or services

Historically, ipso facto clauses have been permitted as emanating from the principle of freedom of contract. The underlying party autonomy is at the heart of English commercial law. It was held to be desirable that the "courts give effect to contractual terms which parties have agreed."[18] The case for party autonomy is particularly compelling when dealing with complex financial instruments or arrangements involving large corporate groups and parties with equal bargaining power.[19]

Under English law, prior to the most recent reforms (i.e. CIGA), it was generally assumed that provisions for the termination of a contract upon insolvency or liquidation of a party were valid.[20] The UK Supreme Court

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16 Instead of exercising acceleration rights, lenders can also choose to request a fee for waiving the default. See L. Hornuf, M. Reps, S. Schäferling, Covenants in European investment-grade corporate bonds, Capital Markets Law Journal, Vol. 10, 2015, p. 358.

17 D. Hahn, The Roles of Acceleration, DePaul Business and Commercial Law Journal, Vol. 8, 2010, p. 231, arguing that "beyond facilitating collection, acceleration's primary role is to enhance a creditor's control and governance."

18 *Perpetual Trustee Company Ltd & Anor v. BNY Corporate Trustee Services Ltd & Ors* [2009] EWCA Civ 1160, at 58.

19 Ibid.

20 A few exceptions applied to the supply of utilities, such as gas, water, and electricity (section 233 Insolvency Act 1986). With the adoption of the Insolvency (Protection of Essential Supplies) Order 2015, protection against termination of essential supplies was extended to cover communication and other electronic services and hardware under sections 233 and 233A Insolvency Act 1986 (information, advice and technical assistance in connection with the use of IT, data storage and processing, website hosting, etc.). Finch and Milman note that the inclusion of new provisions, applicable after 1 October 2015, "represents a considerable victory for the business recue lobby." V. Finch, D. Milman, Corporate Insolvency Law: Perspectives and Principles, 3rd edn, CUP, 2017, p. 515.

confirmed this view in *Belmont Park Investments Pty Ltd*,[21] as long as these provisions did not breach the anti-deprivation rule. This rule protects creditors by preserving the assets of a debtor on or after the onset of insolvency.[22] Its main purpose is to prevent the "intentional or inevitable evasion of the principle that the debtor's property is part of the insolvent estate."[23] The scope of the anti-deprivation rule is limited and narrow.[24] It does not apply to "bona fide commercial transactions which do not have as their predominant purpose, or one of their main purposes, the deprivation of the property of one of the parties on bankruptcy."[25] Ipso facto clauses typically do not have as their "main" purpose the deprivation of the debtor of its property, particularly in financial transactions.[26] Thus, these clauses would generally be considered commercially sensible and therefore are likely to survive the anti-deprivation rule.[27] In this respect, a distinction is made between "a commercial re-arrangement of rights to reflect the economic consequences of insolvency and an attempt to pre-empt the distribution of assets in a bankrupt estate."[28] This is a quid pro quo analysis.

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21 *Belmont Park Investments Pty Ltd v. BNY Corporate Trustee Services Ltd Butters v. BBC Worldwide Ltd* [2011] UKSC 38.

22 The anti-deprivation rule asserts that "there cannot be a valid contract that a man's property shall remain his until his bankruptcy, and on the happening of that event shall go over to someone else, and be taken away from his creditors." *Ex parte Jay, In re Harrison* (1880) 14 Ch D 19, at 26 (Cotton LJ); *Mayhew v. King* [2011] EWCA Civ 328, concluding that a clause that releases a chose in action (claim) upon insolvency, effectively removing the asset from the debtor's creditors, infringes the anti-deprivation principle. The purported "contracting out" of the insolvency legislation is contrary to public policy.

23 *Belmont Park Investments Pty Ltd v. BNY Corporate Trustee Services Ltd Butters v. BBC Worldwide Ltd* [2011] UKSC 38, at 106.

24 F. Toube, J. Rumley, A Brave New World? Should the UK Ban Ipso Facto Clauses in Non-Executory Contracts? Insolvency Intelligence, 31(3), 2018, p. 78; L. Gullifer, J. Payne, Corporate Finance Law: Principles and Policy, 3rd edn, Hart Publishing, 2020, p. 111, noting that "the principle is of limited application"; E. Vaccari, The normative and jural meanings of the anti-deprivation principle *vis-à-vis* freedom of contract, International Insolvency Review, Vol. 31, 2022, pp. 235-274.

25 *Belmont Park Investments Pty Ltd v. BNY Corporate Trustee Services Ltd Butters v. BBC Worldwide Ltd* [2011] UKSC 38, at 104.

26 B. Wessels, S. Madaus (eds), Rescue of Business in Europe: A European Law Institute Instrument, OUP, 2020, p. 208. Goode convincingly argues that a contractual right may in practice constitute a valuable asset, whose termination can diminish assets available to creditors, "so that in form and in substance the termination operates as forfeiture." R. Goode, Principles of Corporate Insolvency Law, 4th edn, Sweet & Maxwell, 2011, p. 222.

27 *Fibria Celulose S/A v Pan Ocean Co. Ltd & Anor* [2014] EWHC 2124 (Ch). Notably, in 2020, the Supreme Court of Canada in *Chandos Construction Ltd v. Deloitte Restructuring Inc*, 2020 SCC 25, confirmed an effects-based approach in Canada to the anti-deprivation rule. This is in contrast to the commercial reasonableness test adopted in the UK. Hence, ipso facto clauses are likely to be held unenforceable in Canada pursuant to common law. This is in addition to the statutory prohibitions implemented over the last few decades. See J. Sarra, J. Payne, S. Madaus, The Promise and Perils of Regulating Ipso Facto Clauses, International Insolvency Review, Vol. 31, 2022, p. 49 and p. 54.

28 *Lomas v. JFB Firth Rixson Inc* [2012] 2 All.E.R. (Comm) 1076, at 91.

The CIGA came into force on 26 June 2020 and introduced new procedures and measures to rescue companies in financial distress.[29] Among other innovations, the insolvency law reform has led to the limitation of ipso facto clauses, which cease to have effect. According to section 233B(3) of the Insolvency Act 1986:

> A provision of a contract for the supply of goods or services to the company ceases to have effect when the company becomes subject to the relevant insolvency procedure if and to the extent that, under the provision (a) the contract or the supply would terminate, or any other thing would take place, because the company becomes subject to the relevant insolvency procedure, or (b) the supplier would be entitled to terminate the contract or the supply, or to do any other thing, because the company becomes subject to the relevant insolvency procedure.

The limitation is linked to the opening of the "relevant insolvency procedure", which includes the majority of insolvency or liquidation procedures, including the new standalone moratorium, Part 26A restructuring plan (but not schemes of arrangement[30]), administration, company voluntary arrangement and liquidation. The inclusion of the liquidation procedure in the list of relevant procedures is puzzling since it does not aim to rescue companies in financial distress. Typically, liquidation results in the immediate cessation of trading for the debtor company and the piecemeal sale of its assets.[31]

Many contracts are excluded from the scope of the rule that curbs the effectiveness of ipso facto clauses. For example, the carve-out extends to loans, financial leases, swap agreements and the provision of guarantees and commitments.[32] It also covers specified categories of persons involved in financial services, such as depository and investment banks, insurers and

29 For background of reforms, see S. Frisby, Of rights and rescue: a curious confluence? Journal of Corporate Law Studies, Vol. 20, 2020, pp. 39-72.

30 Wood notes that since schemes of arrangement are not considered to be insolvency procedures, they "usually will not spark insolvency forfeiture clauses in contracts or leases or cross-default clauses in bonds." P. Wood, Principles of International Insolvency, 2nd edn, Sweet & Maxwell, 2007, para. 23-038. Interestingly, schemes are included in the relevant ipso facto rules in Australia (Corporations Act 2001, s. 415D) and Singapore (IRDA, s. 440(6)).

31 S. Paterson, The analytical boundary between corporate reorganisation and sale in corporate bankruptcy theory, in P.J. Omar and J.L.L. Gant (eds), Research Handbook on Corporate Restructuring, Edward Elgar Publishing, 2021, p. 537, observing that if the policy behind the ban is to solve the collective action problem, "then it seems surprising that it may apply where the strategy for the bankruptcy case is to sell assets on a break-up basis."

32 Schedule 4ZZA to the Insolvency Act 1986. Other contracts may also be excluded as not being contracts for the "supply of goods or services". These include licenses, property leases and agreements for the sale of land. See Explanatory notes to CIGA, para. 231 <https://www.legislation.gov.uk/ukpga/2020/12/notes/division/6/index.htm> (accessed 15 July 2023).

investment firms.[33] These persons are excluded from section 233B, irrespective of whether they are an insolvent debtor or the supplier. As a result, parties involved in the carved-out matters can still withdraw committed funds, change default interest, accelerate debt and call up guarantees upon a debtor's insolvency filing and other insolvency-related events. Arguably, this carve-out is essential because, without it, financial creditors might be incentivised to incorporate earlier triggers in their contracts, potentially leading to withdrawals at a point where insolvency is merely likely. Given the focus of this book on financial arrangements, such as loans, bonds, and guarantees, the ineffectiveness of ipso facto clauses under English law is of limited relevance for our discussion. Thus, the principle of freedom of contract continues to prevail, governing the attitude towards ipso facto clauses in intra-group financing.

9.3.2 The USA: executory contracts and safe harbours

Before the enactment of the Bankruptcy Reform Act of 1978, ipso facto clauses were honoured under US bankruptcy law.[34] Although in a number of cases they were not treated with favour,[35] express and unambiguous contractual clauses and covenants of forfeiture – in effect ipso facto clauses – were held to be enforceable against the trustee in bankruptcy. This was irrespective of the nature of proceedings, insolvent liquidation or reorganisation.

Just like in the UK, the change in the attitude toward the validity of ipso facto clauses in the USA required statutory intervention. This happened with the adoption of the US Bankruptcy Code in 1978. The shift towards the prohibition of ipso facto clauses can be attributed to the overall move in the direction of rehabilitating financially troubled companies.[36] Levitin explains

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33 Schedule 4ZZA to the Insolvency Act 1986.

34 For a detailed historical account, see V. Countryman, Executory Contracts in Bankruptcy: Part II, Minnesota Law Review, Vol. 58, 1974, pp. 479-567.

35 In a few cases, courts, guided by considerations of equity and public interest, barred the enforcement of ipso facto clauses in order to prevent forfeiture. See e.g. *Queens Blvd. Wine and Liquor Corp. v. Blum*, 503 F.2d 202 (1974), holding that a court may deny enforcement of a bankruptcy forfeiture clause on equitable grounds, where contract termination would be "grossly inequitable and contrary to the salutary purpose of Chapter XI." See also *Weaver v. Hutson*, 459 F.2d 741 (4th Cir. 1972); *Queens Blvd. Wine & Liquor Corp. v. Blum*, 503 F.2d 202 (2d Cir. 1979).

36 S. Block-Lieb, Fishing in Muddy Waters: Clarifying the Common Pool Analogy as Applied to the Standard for Commencement of a Bankruptcy Case, American University Law Review, Vol. 42, 1993, p. 424, highlighting that the goal of debtor's financial rehabilitation was distinct from that of increasing distributions to creditors. See also Report of the Committee on the Judiciary together with Separate Supplemental, and Separate Additional Views, H.R. Rep. No. 95-595 (1977) 348, explaining that the goal of § 365(e)(1) is to restrict the application of clauses that frequently hamper rehabilitation efforts.

that "there is a strong general bankruptcy policy concern about ipso facto clauses because [they] can function as punitive liquidated damages provisions and work at odds with Chapter 11's reorganisation preference and with Chapter 7's equitable distribution principle."[37]

To promote the debtor's rescue prospects and protect the debtor from losing valuable contractual rights, the US Bankruptcy Code limits freedom of contract and deprives ipso facto clauses of their legal force. In addition to invalidating ipso facto clauses, the law excuses them from the cure requirements for assumption purposes.[38] As a result, any defaults on account of ipso facto clauses could be ignored, and a counterparty may not terminate the contract or demand payment based solely on an event of default triggered by an ipso facto clause.

The US Bankruptcy Code stipulates in § 365(e)(1) that:

> Notwithstanding a provision in an executory contract or unexpired lease, […] an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on -
> (A) the insolvency or financial condition of the debtor at any time before the closing of the case;
> (B) the commencement of a case under this title; or
> (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.[39]

Under this provision, a clause providing for the termination or modification of an executory contract or lease conditioned on the debtor's insolvency, commencement of a bankruptcy case, or the appointment of a receiver or custodian is inoperative. The prohibition of ipso facto clauses also extends to clauses that have the same effect as a clause triggered by a bankruptcy filing. For instance, a clause conditioned on the debtor's financial health or the increased financial risks is invalid "because it is most likely to operate in the vicinity of a bankruptcy case."[40] Financial distress is usually a good indicator of a forthcoming bankruptcy filing.

From § 365(e)(1), it follows that the limits imposed on ipso facto clauses apply only to contracts which are considered to be *executory*, and to unexpired leases. Whereas the meaning of the latter is not controversial, the former has become an arena for fierce litigation and has led to different

37 A.J. Levitin, Business Bankruptcy: Financial Restructuring and Modern Commercial Markets, Wolters Kluwer, 2016, p. 840.
38 11 U.S. Code § 365(b)(2).
39 11 U.S. Code § 365(e)(1).
40 Collier on Bankruptcy, 16th edn, 2022, Vol. 3, ¶ 365.08[1].

interpretations.[41] Courts have had great difficulty in developing a workable and coherent definition of what constitutes an executory contract. As one commentator observed, the law of executory contracts in bankruptcy law is characterised by "a hopelessly convoluted and contradictory jurisprudence."[42] We will not try to cover different approaches and definitions but instead consider an executory contract to be a contract in which both parties continue to have ongoing obligations to each another. In other words, performance remains due to some extent on both sides.[43] If performance by one party to the contract has been fully completed, it is no longer an executory contract. This is why loan agreements are typically not considered to be executory, as one of the parties (e.g. lender) does not have ongoing material obligations. This is the case where the loan is fully funded.[44]

But what if the lender has material outstanding obligations?[45] Some courts have held broadly that "loan agreements are generally not considered to be executory contracts" and therefore ipso facto clauses contained therein

41 J.A.E. Pottow, A New Approach to Executory Contracts, Texas Law Review, Vol. 96, 2018, p. 1438, noting that "a judicial cottage industry in bankruptcy has developed on the definition of "executoriness" and concomitant scope of access to § 365."

42 M.T. Andrew, Executory Contracts Revisited: A Reply to Professor Westbrook, University of Colorado Law Review, Vol. 62, 1991, p. 2. See also J.L. Westbrook, K.S. White, The Demystification of Contracts in Bankruptcy, American Bankruptcy Law Journal, Vol. 91, 2017, pp. 481-562.

43 The term "executory contract" is not defined in the US Bankruptcy Code. There are essentially three approaches to executoriness. One of them refers to the definition suggested by Countryman (so-called Countryman Test). Under it, an executory contract is "a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other." V. Countryman, Executory Contracts in Bankruptcy: Part I, Minnesota Law Review, Vol. 57, 1973, p. 460. *In re Perm Traffic Co.*, 524 F.3d 373, 379 (2d Cir. 2008); *In re Weinstein Co. Holdings LLC*, 997 F.3d 497, 504 (3d Cir. 2021). The materiality of the breach under the Countryman Test is a factual question resolved through the application of state law. Another, similar but less stringent test is a "some performance due" standard cited in the legislative history. *In re Waldron*, 36 B.R. 633 (Bankr. S.D.Fla. 1984). The third approach is the functional one. According to it, "the question of whether a contract is executory is determined by the benefits that assumption or rejection would produce for the estate." *Sipes v. Atlantic Gulf Communities Corp.*, 84 F.3d 1364, 1375 (11th Cir.1996). See J.L. Westbrook, A Functional Analysis of Executory Contracts, Minnesota Law Review, Vol. 74, 1989, pp. 227-338.

44 *In re Calpine Corp.*, 50 Bankr. Ct. Dec. 92, 2008 WL 3154763 (Bankr. S.D. N.Y. 2008), noting that there were no mutual performance obligations, because there was no performance remaining due from the lender under the loan agreement. *In re Moody Nat. SHS Houston H, LLC*, 426 B.R. 667 (Bankr. S.D. Tex. 2010), holding that a mortgage note was neither a lease nor an executory contract. See also H.R. Rep. No. 95-595, 2d Sess. 347, reprinted in 1978 U.S. Code Cong. & Admin. News, pp. 5963 ("note is not usually an executory contract if the only performance that remains is repayment.").

45 E.A. Kleinhaus, P.B. Zuckerman, The Enforceability of Ipso Facto Clauses in Financing Agreements: American Airlines and Beyond, Norton Journal of Bankruptcy Law and Practice, Vol. 23, 2014, pp. 193-211.

are valid and enforceable (e.g. triggering the lender's right to interest at the default rate).[46] In a few other cases, it was simply assumed and not disputed by the parties that financing agreements are non-executory.[47] A more nuanced view is that a credit agreement can be an executory contract if the lender has unfulfilled loan commitments.[48] The minority of courts have adopted the position that the bar on ipso facto clauses extends beyond situations directly addressed in the US Bankruptcy Code, such that an ipso facto ban can also apply to non-executory contracts.[49]

The difficulty of determining whether a contract is executory also applies to guarantee arrangements, such as surety bonds. In the tripartite relations, one party (surety) is liable for the principal's or obligor's debt or duty to the third-party obligee (creditor). In *Argonaut Insurance Company v. Falcon V, L.L.C.*,[50] the principal debtors (Debtors) contracted with Argonaut (surety) to issue irrevocable performance bonds that would cover claims of the third-party lessors (creditors). In exchange, Debtors agreed to pay premiums and indemnify Argonaut for claims of third parties, should Argonaut be required to satisfy them.

Following the Debtor's Chapter 11 filing, Argonaut argued that the surety bond program was deemed assumed by the plan because it was not rejected. Debtors responded that the surety bond program was not an executory contract and that Argonaut's claims had been discharged in bankruptcy. The court concluded that the surety bond was not an executory contract because Argonaut owed no additional performance to Debtors after posting the surety bonds. The only remaining duty of Argonaut was a contingent

46 *In Re General Growth Properties, Inc.*, 451 B.R. 323 (Bankr. S.D.N.Y. 2011).

47 See e.g. *In re AMR Corp.*, 485 B.R. 279, 296-97 (Bankr. S.D.N.Y. 2013) ("As both U.S. Bank and the Debtors admit that the Indentures here are not executory contracts or unexpired leases […] the Court concludes that […] is not an invalid ipso facto clause"); *In re A & B Assocs., L.P.*, 2019 WL 1470892 (Bankr. S.D. Ga. Mar. 29, 2019) ("Neither party has asserted that the Loan Agreement is an executory contract, much less an unexpired lease").

48 *In re Cardinal Industries, Inc.*, 146 B.R. 720, 730 (Bankr. S.D. Ohio 1992), concluding that a credit agreement was an executory contract, because each party had remaining "material" obligations under it. *Whinnery v. Bank of Onalaska (In re Taggatz)*, 106 B.R. 983, 991 (Bankr. W. D. Wis.1989), finding that a contract is executory where the debtor owed on a note and the bank had not completely funded the note.

49 *In re W.R. Grace & Co.*, 475 B.R. 34, 153 (D. Del. 2012), refusing to enforce an ipso facto clause that would have entitled the lender with default interest upon the debtor's insolvency filing and holding that the "ban on ipso facto clauses has been interpreted to be much broader than the confines of §§ 541(c) and 365(e)(1)." The court referred to *In re Rose*, 21 B.R. 272 (Bankr. D.N.J.1982), finding that even though the contract in issue was non-executory, the bankruptcy-related default clause could still not be enforced because it was contrary to the central purpose of the US Bankruptcy Code.

50 *Argonaut Insurance Company v. Falcon V, L.L.C.*, 2021 WL 4486336 (M.D. La. 2021), affirming *In re Falcon V, L.L.C.*, 620 B.R. 256 (Bankr. M.D.La. 2020). For similar findings, see *In re James River Coal Co.*, 2006 WL 2548456 (M.D. Tenn. 2006).

obligation to third parties. The court also pointed out that Debtor's failure to perform (i.e. pay bond premiums) did not create a material breach that could excuse Argonaut's performance. Instead, such a failure expressly triggered Argonaut's obligations under the surety bond.

On appeal, Argonaut emphasised that it still owed obligations to third parties under the surety bond program and that these obligations should be taken into account when deciding whether the contract in question was executory or not. Importantly, the Fifth Circuit accepted that courts should apply the relevant test "to multiparty contracts in a flexible manner that accounts for the various obligations owed to all of the parties, rather than focusing exclusively on the flow of obligations between the debtor and the creditor."[51] Nevertheless, it concluded that the surety contract was not executory because the surety would not be excused from its obligations even if Debtors failed to perform, since the performance bonds were irrevocable. In another, much earlier case, however, it was held that a surety bond contract, a contract between a surety and a principal debtor, was "clearly executory".[52]

The cited cases concern the legal relationship between the principal debtor and the guarantor (*bankrupt debtor → guarantor*). US courts also considered whether the guarantee itself, as a relationship between the bankrupt guarantor and the creditor (*bankrupt guarantor → creditor*), falls within the term "executory contract". They generally found that a guarantee was not an executory contract.[53] As one court concluded in this respect, the "guarantor is […] no more entitled to reject his agreement of guaranty than would any bankrupt be entitled to 'reject' his accrued debts."[54] Finally, when it comes to the relationship between the creditor and a non-bankrupt guarantor (*creditor → non-bankrupt guarantor*), one court determined that the non-bankrupt guarantor cannot benefit from the bankruptcy prohibition of ipso facto clauses in a situation where the payment obligation is triggered by the bankruptcy of the debtor. The court accepted that the law does not explicitly state that only the bankrupt can invoke an ipso facto ban but argued that the rule against ipso facto clauses was introduced to protect against the clauses diluting the bankrupt's interests – not the interests of a third party.[55] Notably, the court clarified that it did not mean to say that a third non-bankrupt party can never rely on § 365(e)(1).

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51 *Matter of Falcon V, L.L.C.*, 44 F.4th 348, 354 (C.A.5 (La.), 2022).

52 *In re Evans Products Co.*, 91 B.R. 1003 (Bankr. S.D. Fla. 1988).

53 *In re Furniture Brands International, Inc.*, 2013 WL 9065131 (Bankr. D.Del. 2013), noting that the guarantee does not contain ongoing material obligations to the guarantor by the creditor.

54 *In re Grayson–Robinson Stores, Inc.*, 321 F.2d 500, 502 (2d Cir.1963).

55 *Liberty Mut. Ins. Co. v. Greenwich Ins. Co.*, 417 F.3d 193 (1st Cir. 2005).

The US Bankruptcy Code includes a number of exceptions (safe harbours) that permit the enforcement of ipso facto clauses in contracts, typically concluded with sophisticated financial participants, even if these contracts are executory (securities contracts, commodities and forward contracts, repos, swaps, master netting arrangements, etc.).[56] Crucially for the purposes of this book, the law also explicitly excludes from the scope of the ipso facto ban an executory contract that is "a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor."[57]

Hence, if a loan agreement is considered to be executory, a lender could terminate such an agreement, or refuse to make additional payments or grant future credit (e.g. pursuant to a revolving credit facility) upon the commencement of a bankruptcy case.[58] This prevents the trustee or debtor in possession from requiring new advances of money or other property under the existing financial contracts. As a result, pre-petition creditors cannot be forced to extend further credit after the bankruptcy petition has been filed. Therefore, whether a loan agreement is executory or non-executory may have no real difference. If it is non-executory, the ban on ipso facto clauses, pursuant to the prevailing view, does not apply (*non-executory → ipso facto clause allowed*). If it is executory, as may be the case of a revolving credit facility, the ipso facto ban will equally have no bearing (*executory, but exception applies → ipso facto clause allowed*). Either way, the lender is able to terminate the contract and refuse advancing additional funds to the bankrupt, even if the lender had an obligation to do so. This brings US law closer to English law, as both seek to safeguard the effectiveness of ipso facto clauses in financial contracts.

56 See e.g. 11 U.S. Code § 555-561. For discussion of rationale behind safe harbors, see M.D. Sherrill, In Defense of the Bankruptcy Code's Safe Harbors, The Business Lawyer, Vol. 70, 2015, pp. 1007-1037.

57 11 U.S. Code § 365(e)(2)(b). The term "financial accommodations" is not explained in the US Bankruptcy Code but courts define it narrowly as the extension of money or credit to accommodate another. In a number of cases, it was held that guaranty and surety contracts and other contracts the principal purpose of which is to extend financing to or guarantee the financial obligations are contracts to extend financial accommodations. See *In re Sun Runner Marine, Inc.*, 945 F.2d 1089 (9th Cir.1991), concerning an agreement between a financial institution and the debtor (a boat manufacturer), under which the financial institution made loans to the debtor's boat dealers, but the proceeds of the loans were disbursed directly to the debtor, and the debtor incurred secondary liability for the repayment of the loans to dealers. *In re Falcon V, L.L.C.*, 620 B.R. 256 (Bankr. M.D.La. 2020), concluding that the surety bond program is a financial accommodation. See also *In re Wegner Farms Co.*, 49 B.R. 440 (Bankr. N.D. Iowa 1985); *In re Thomas B. Hamilton Co.*, 969 F.2d 1013 (11th Cir. 1992).

58 *Mims v. Fidelity Funding, Inc.*, 307 B.R. 849 (N.D. Tex. 2002), holding the acceleration clause in a loan agreement enforceable as falling under the exception of § 365(e)(2)(b); *In re Marcus Lee Associates, L.P.*, 422 B.R. 21 (Bankr. E.D. Pa. 2009); *In re Watts*, 876 F.2d 1090 (3d Cir. 1989).

9.3.3 The Netherlands: WHOA schemes and obligations towards debtors

Dutch law does not contain a general rule on ipso facto clauses.[59] In a few cases, Dutch courts have considered ipso facto clauses to be valid and enforceable based on the specific facts of each individual case.[60] Their effectiveness was recognised by the Dutch Supreme Court in *BaByXL/ALM*.[61] In this case, the court analysed a provision in the agreement for the lease of computer equipment. The provision in question entitled the lessor to terminate the agreement if the lessee entered the suspension of payments procedure, and to claim compensation up to an amount equal to all the remaining lease payments that would have been chargeable under normal performance of the agreement.

The lessee argued that the purpose of the suspension of payments was to keep the debtor's business going, which, according to the lessee, would not be achieved if the lessor had the right to terminate the lease agreement prematurely. The court disagreed and held that Dutch law did not preclude the inclusion of a provision such as the one at hand in the lease agreement that offers the lessor an option to terminate the lease agreement prematurely in the event of the suspension of payments (a type of procedure under Fw). It noted that Article 238 Fw offers the tenant an option to prematurely terminate the lease in the interests of the estate. Yet it does not prohibit (early) termination of the lease by the lessor.

The court reminded that, as a general rule, neither bankruptcy nor suspension of payments affected the existing agreements of the debtor and did not deprive the lessor of contractual rights. This conclusion did not change because of the rehabilitative nature of the procedure. However, it was observed that Article 6:248(2) BW could in principle be invoked to refuse giving effect to a provision in a contract if such effect would be unacceptable (*onaanvaardbaar*) in the given circumstances according to the standards of reasonableness and fairness. This is especially so in a situation where the continued payment of rent is guaranteed. Yet in this case, the court did not have to consider whether the clause was unacceptable under the standards of reasonableness and fairness, as the issue was not raised on appeal.

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59 Like English law before the CIGA reforms, Dutch law before the WHOA contained a single provision limiting ipso facto clauses in contracts concerning utilities – gas, water, electricity and heating necessary for the continuation of the debtor's business. See Articles 37b and 237b Fw.

60 D. Faber and N. Vermunt, National Report for the Netherlands, in D. Faber et al. (eds), Treatment of Contracts in Insolvency, OUP, 2013, para. 12.95.

61 HR 13 May 2005, *JOR* 2005/222, *NJ* 2005/406, m.nt. P. van Schilfgaarde (*BaByXL/ALM*).

Another case where an ipso facto clause was scrutinised is *Megapool/Laser*.[62] Megapool BV (Megapool) was a retail chain that sold kitchen and household appliances. Laser Nederland BV (Laser) and Megapool concluded an agreement under which consumers were allowed to use Laser's credit when financing purchases from Megapool. To this end, consumers were given a card, the MegaCard, with which they could make purchases within the limits of the credit facility made available to them by Laser. If a consumer used this card for a purchase at Megapool, the purchase amount was paid directly to Megapool by Laser. If a consumer had not paid Laser the purchase amount within six months, he was obliged to take out a loan with Laser for a term of up to three years. In such a case, Megapool received a commission from Laser. However, the right to the commission lapsed upon certain events, including termination of the agreement due to the insolvency of a counterparty. Magapool was declared bankrupt in 2004, and Laser terminated the agreement with it.

The trustees of Megapool took the position that the termination of the agreement by Laser did not result in a loss of Megapool's right to the commission. They argued that the clause affecting such a right was null and void due to being contrary to public policy (*openbare orde*) and good morals (*goede zeden*)[63] as it disproportionately affected creditors in the event of insolvency. The trustees claimed that reliance on the aforementioned clause was unacceptable according to standards of reasonableness and fairness.[64]

The court observed that if the clause deprives the debtor of its property – that which the debtor is entitled to but does not get – such a clause may contravene Article 20 Fw.[65] This is similar to the operation of the anti-deprivation rule under English law. The court stated that if the clause terminates the right to performance solely due to an insolvency event – with the result that the other party, which has already received the consideration for it, no longer needs to effectuate its own performance – such a clause may, depending on the context and other circumstances, be null and void. It also stressed that there is a possibility that invoking such a clause can be unacceptable in the given circumstances based on standards of reasonableness and fairness.[66] Yet these considerations did not apply to the case at hand, as the commission constituted the consideration for performance and benefits, which were lost as a result of Megapool's insolvency.[67] The trustees' claim failed in view of this interpretation. Nevertheless, the reasoning of the court

62 HR 12 April 2013, *NJ* 2013/224, *JOR* 2013/193, m.nt. J.J. van Hees (*Megapool/Laser*).

63 Dutch Civil Code, Article 3:40.

64 Dutch Civil Code, Article 6:248(2). H.N. Schelhaas, Redelijkheid en billijkheid (Monografieen BW), Wolters Kluwer, 2017.

65 Article 20 Fw establishes that "the bankruptcy includes the entire assets of the debtor at the time of the bankruptcy order, as well as what it acquires during the bankruptcy."

66 HR 12 April 2013 (*Megapool/Laser*), 3.4.2.

67 Ibid., at 3.4.4.

confirms that insolvency-triggered clauses in principle can be annulled if they deprive the debtor of its property or if they fail to meet standards of reasonableness and fairness – a demanding test to pass. Decisive are the circumstances of the case, including the context of the agreement and the purpose of the clause itself.[68]

The possibility to enforce ipso facto clauses under Dutch law has attracted some criticism in academic literature, particularly in view of its (likely) negative impact on debtors' chances of restructuring and the position of unsecured creditors.[69] The Explanatory Memorandum to the WHOA asserts that "[i]t is crucial for the survival of the company that [current] agreements are maintained, particularly where its business operations depend on certain contracts, such as those with suppliers, customers, employees and IT specialists."[70] The desire to preserve valuable contracts and promote corporate rescue was the driving force behind the adoption of the WHOA. Article 373(3) Fw provides that:

> The preparation and offering of a restructuring plan as referred to in Article 370(1), and the appointment of a plan expert as referred to in Article 371, as well as events and actions directly related to this or to the execution of the restructuring plan and reasonably necessary for that purpose, do not constitute grounds for amendment of obligations or undertakings towards the debtor, for the suspension of any obligation towards the debtor and for termination of an agreement concluded with the debtor.

The restrictions on the effects of ipso facto clauses introduced by the WHOA are substantial. First, unlike the US Bankruptcy Code and the UK's Insolvency Act 1986, Article 373(3) Fw applies to a wide range of agreements ("obligations or undertakings towards the debtor"), including loan agreements.

68 Rb. Midden-Nederland 11 March 2015, r.o. 4.23ff, *JOR* 2015/342 (*Van Dijk q.q./Reaal-Srlev*). F.M.J. Verstijlen, De betrekkelijke continuïteit van het contract binnen faillissement, in W.J.M. van Andel & F.M.J. Verstijlen, Materieel faillissementsrecht: de Peeters/Gatzen-vordering en de overeenkomst binnen faillissement. Preadviezen 2006 uitgebracht voor de Vereniging voor Burgerlijk Recht, Kluwer: Deventer 2006; T.T. van Zanten, De overeenkomst in het insolventierecht (Recht en Praktijk, nr. InsR3), Deventer, Kluwer 2012.

69 T. van Zanten, Het lot van de overeenkomst bij insolventie: Stormachtige ontwikkelingen op het snijvlak van het overeenkomsten- en insolventierecht, TvI 2020/49, noting with respect to contractual clauses that aim to regulate a situation in which one of the parties to a contract becomes insolvent: "Although such clauses certainly do not always have to be based on improper motives, they should always be treated with scepticism. Such a clause is intended to mitigate the adverse consequences of insolvency for one party in some way, which will generally be at the expense of the recovery of the joint creditors." N.W.A. Tollenaar, Het pre-insolventieakkoord. Grondslagen en raamwerk (diss. Groningen), Deventer: Wolters Kluwer 2016, 8.2.7.1, observing that enforcing a termination clause may be to the "detriment of the creditors as a group, who have to watch with sadness how the contracting party withdraws the value of the contract from "the estate" without any real ground."

70 MvT, *Kamerstukken II* 2018/19, 35249, 3.

Second, the preparation or implementation of a WHOA scheme (also referred to as a WHOA plan or restructuring plan) cannot be relied upon as a ground to invoke Article 6:80 BW. This article covers a situation where, before the claim becomes due and payable, it is established that the debtor will most likely fail to duly perform an obligation.[71] In effect, the debtor may be regarded to be in default, although technically no default has yet occurred. The operation of Article 6:80 BW is comparable to that of the Anglo-American doctrine of "anticipatory breach of contract".

Third, an event with which an ipso facto clause associates the termination or amendment of a contract is understood to include the preparation and offering of a restructuring plan and "events and actions directly related to this or to the execution of the restructuring plan and reasonably necessary for that purpose." Given that the Dutch Bankruptcy Act refers to a restructuring plan, the unenforceability of ipso facto clauses seems to be solely reserved for procedures aiming at the adoption of such a restructuring plan – WHOA schemes. As a result, if an ipso facto clause is linked to an event unrelated to the WHOA scheme (e.g. the opening of a bankruptcy proceeding), the limitations on ipso facto clauses will not apply.

In this respect, Dutch law differs from US and UK law, both of which cover a wide range of insolvency procedures, including liquidation procedures. At the same time, even if the clause does not fall within the WHOA's anti-ipso facto regime, it can still be subject to scrutiny and be annulled if it deprives the debtor of its property or if its enforcement is unacceptable under the general standards of reasonableness and fairness.

The figure below summarises the main features of the regulation of ipso facto clauses in the chosen jurisdictions.

71 Asser/Sieburgh 6-I 2020/410.

Figure 7. Prohibition of ipso facto clauses in UK, US and Dutch law

	UK	**USA**	**Netherlands**
Procedures covered	Relevant insolvency procedures (e.g. moratorium, Part 26A plans, administration, CVA, liquidation) but excluding Part 26 schemes	All procedures under the US Bankruptcy Code	Explicitly only WHOA schemes, but potentially other procedures, if the enforcement is unacceptable under the standards of reasonableness and fairness
Contracts covered by the prohibition	Contract for the supply of goods or services	Executory contracts and unexpired leases	In principle, all obligations or undertakings towards the debtor
Contracts excluded from the prohibition	Most financial contracts, including loans, financial leases, swaps and provision of guarantees. The exclusion also applies to the specified categories of persons involved in financial services (e.g. depository & investment banks, insurers and investment firms	A wide range of financial contracts, including forward contracts, swaps, repos, as well as a contract to make a loan, extend other debt financing or financial accommodation	Financial framework agreements, such as ISDA Master Agreement and Global Master Repurchase Agreement and other arrangements involving close-out netting and financial collateral

9.3.4 International developments

The emergence of rules seeking to restrict the legal effects of ipso facto clauses has accompanied the enactment of new restructuring laws. Over the recent three decades, but especially during the last five years, an increasing number of jurisdictions reformed their laws and introduced limitations on ipso facto clauses to promote corporate rescue. Some of these jurisdictions are mentioned below.

Figure 8. Restriction of ipso facto clauses

Jurisdiction	Year	Law
Canada	1992, 2005, 2007, 2009[72]	Bankruptcy and Insolvency Act (BIA), sec. 65.1, 66.34, and 84.2; Companies' Creditors Arrangement Act (CCAA), sec. 34
Mexico	2000	Commercial Insolvency Law (*Ley de Concursos Mercantiles*), Article 87
France	2005	Commercial Code (*Code de commerce*), Article L. 622-13
Austria	2010	Insolvency Act (*Insolvenzordnung*), § 25b(2)
EU	2014	Bank Recovery and Resolution Directive, Articles 68 and 71
Australia	2018	Corporations Act 2001, sec. 415D, 434J, 451E[73]
Singapore	2018	Insolvency, Restructuring and Dissolution Act 2018, sec. 440[74]
EU	2019	Restructuring Directive, Article 7(5)
UK	2020 (in force since 26 June 2020)	Corporate Insolvency and Governance Act 2020, adding sec. 223B to the Insolvency Act 1986 (some limitations for specific contracts applied earlier)
Netherlands	2020 (in force since 1 January 2021)	Act on Court Confirmation of Extrajudicial Restructuring Plans (WHOA), Article 373(3) Fw
Germany	2020 (in force since 1 January 2021)	Enterprise Stabilization and Restructuring Act (StaRUG), § 44[75]
Austria	2021 (in force since 17 July 2021)	Restructuring Regulation (*Restrukturierungsordnung* or ReO), §26(3)

72 The relevant provisions invalidating ipso facto clauses were adopted gradually. A. Ho, The Treatment of Ipso Facto Clauses in Canada, McGill Law Journal, Vol. 61, 2015, pp. 139-189. The CCAA was amended in 2009 to expressly embed protections against ipso facto clauses. Prior to 2009, Canadian courts approved such protections in initial orders granting the commencement of CCAA proceedings. A. Duggan et al., Canadian Bankruptcy and Insolvency Law: Cases, Text, and Materials, 3rd edn, Emond Montgomery Publications, 2015, p. 296.

73 Australian law introduces many exclusions from the rule against ipso facto clauses, some of which cover common commercial contracts. C. Symes and J. Harris, Be Careful What You Wish For! Evaluating the Ipso Facto Reforms, OBLB, 13 September 2019. *Rathner, in the matter of Citius Property Pty Ltd (Administrator Appointed)* [2023] FCA 26.

74 In Singapore, the restrictions on ipso facto clauses apply in specified proceedings, which do not include winding up or receivership – proceedings which are not concerned with rehabilitation of distressed companies. A number of "eligible financial contracts" are excluded from the ipso facto regime, including derivatives agreements, repos, contracts to borrow or lend securities or commodities and margin loans. See further, M. Tan, K. Han, A Comparative Look at the Ipso Facto Regime, Singapore Academy of Law, SAL Prac 1, 2021.

75 The limitation of ipso facto clauses was previously derived from § 119 InsO, which aims to protect the right of an IP to accept and reject executory contracts. See BGH, Urteil vom 15. November 2012, BGHZ 195, 348 = NJW 2013, 1159.

This trend toward the "deactivation" (or a temporary stay) of ipso facto clauses has been supported by standard-setting organisations, both in the area of corporate insolvency and bank resolution.[76] Determining to what extent freedom of contract should be curbed to promote other legitimate values or goals, such as effective restructuring and estate value maximisation, is a policy question. Despite the fact that the same set of arguments is often used to rationalise constrains on ipso facto clauses, divergent legal regimes arose across jurisdictions. In countries like the UK and the USA, certain contracts or persons are explicitly carved out from the prohibition (e.g. financial contracts). In other countries (e.g. the Netherlands), the material scope of the prohibition is broader (i.e. loan agreements are not carved out), yet the scope may be limited by the types of procedures that trigger the prohibition (e.g. WHOA schemes).

9.4 Enforceability of Cross-Default Clauses in Insolvency

9.4.1 The UK: suspension of termination rights during "insolvency period"

The previous section dealt with ipso facto clauses, and we observed that an increasing number of jurisdictions prohibit or impose restrictions on their effectiveness. This section will discuss cross-default clauses. As noted above, the main difference between an ipso facto clause and a cross-default clause – as defined in this book – is that the latter is triggered by a default on a debt obligation or another type of misbehaviour. In practice, both types of clauses may facilitate insolvency,[77] including insolvency within an enterprise group. Both might be used as a bargaining tool to renegotiate contract terms.

In the previous section, it was highlighted that English courts have long accepted and enforced contractual clauses providing for termination or acceleration upon the occurrence of a certain event – an event of default. The same holds true for cross-default clauses. In *Rahman & Ors v. HSBC*

76 UNCITRAL Legislative Guide on Insolvency Law, Part two, 2004, Ch. II, para. 118; EBRD Core Principles of an Effective Insolvency System, September 2020, Principle 11; FSB Key Attributes of Effective Resolution Regimes for Financial Institutions, 2014, Key Attribute 4.3 and I-Annex 5: Temporary stay on early termination rights.

77 Wood argues that cross-defaults have an "inertia effect", so that "[if] everybody can accelerate, nobody can since this spells bankruptcy." P. Wood, International Loans, Bonds, Guarantees, Legal Opinions, Sweet & Maxwell, 2007, para. 6-013. For a similar argument, see L. Gullifer, J. Payne, Corporate Finance Law: Principles and Policy, 2nd edn, Hart Publishing, 2015, p. 213. See also N. Li, Y. Lou, F.P. Vasvari, Default clauses in debt contracts, Review of Accounting Studies, Vol. 20, 2015, p. 1610, pointing out that a cross-default clause "may have an unintended domino effect that could seriously weaken the borrower's financial position."

Bank Plc & Ors,[78] the court recognised the fairness of such clauses and found sound commercial reasons for their inclusion in the agreements.[79] The enforceability of cross-default clauses is in line with the protective attitude of English law towards parties' bargains. This is reflected, inter alia, in the resistance of courts to accept a duty to act in good faith as a general organising principle of law. Relatedly, English courts have repeatedly refused to restrict termination clauses by an implied duty of good faith, especially in contracts between sophisticated parties.[80] Given that prior to the CIGA (and in many cases, after the CIGA, e.g. for financial transactions), ipso facto clauses were held to be valid and enforceable, it is hardly surprising that cross-default clauses have also received legal approval. A cross-default clause is unrelated to insolvency if it is triggered by a failure to pay in time, even though insolvency and the failure to perform substantive obligations may be correlated. An insolvent or nearly insolvent entity is likely to default on at least some of its obligations. Besides, referring to the considerations of the court in *Belmont*, a cross-default clause would usually have a legitimate commercial basis.

The 2020 reforms restricted the effectiveness of ipso facto clauses with the goal of ensuring efficient restructuring. Hence, it is reasonable to examine whether the adoption of the CIGA has changed the approach of English law to cross-default clauses. Section 233B(4) provides that:

78 *Rahman & Ors v. HSBC Bank Plc & Ors* [2012] EWHC 11 (Ch) (17 January 2012). Gullifer and Payne note that the commercial reason of including a cross-default clause in a contract is that "a default in meeting the obligations to one creditor is a good advance warning of financial difficulty." L. Gullifer and J. Payne, Corporate Finance Law: Principles and Policy, 2nd edn, Hart Publishing, 2015, p. 214. For the same observation, see C. Wells and A. Doulai, Till default do us part: facility agreements and acceleration, Butterworths Journal of International Banking and Financial Law, October 2013, p. 573. Also, *Black Diamond Offshore Ltd v. Fomento de Construcciones y Contratas SA* [2015] 4 WLUK 236, holding that a reasonable person would be aware of the fact that a "default on one debt under a particular contract is capable of cross-defaulting other debts under other contracts, setting off a chain reaction."

79 E. Lomnicka, Credit and security, in Chitty on Contracts, Vol II: Specific Contracts, 33rd edn, Sweet & Maxwell, 2018, para. 39-275, noting with respect to cross-default clauses that while "it may be objected that it is unfair to the borrower that a lender should be entitled to require immediate repayment under a loan agreement where the borrower has fully performed all of his obligations under the agreement, there is no doubt that such a clause will be upheld in a commercial agreement." English courts have held that the effects of an acceleration clause cannot be regarded as penalty, since they do not increase the overall obligation. *The Angelic Star* [1988] 1 Lloyd's Rep. 122, 125, 127; *ZCCM Investments Holdings Plc v. Konkola Copper Mines Plc* [2017] EWHC 3288 (Comm), at 37.

80 *TSG Building Services Plc v. South Anglia Housing Limited* [2013] EWHC 1151 (TCC); *Monde Petroleum SA v. Westernzagros Ltd* [2016] EWHC 1472 (Comm); *TAQA Bratani Ltd v. Rockrose UKCS8 LLC 8* [2020] EWHC 58 (Comm). See M.G. Bridge, The Exercise of Contractual Discretion, Law Quarterly Review, Vol. 135, 2019, pp. 227-248.

> Where -
> (a) under a provision of a contract for the supply of goods or services to the company the supplier is entitled to terminate the contract or the supply because of an event occurring before the start of the insolvency period, and (b) the entitlement arises before the start of that period, the entitlement may not be exercised during that period.[81]

The termination right is thus suspended or "frozen" for the duration of the relevant procedure (e.g. administration, restructuring plan, liquidation). This interferes with contractual termination rights. Yet, as with ipso facto clauses, the limitation of freedom of contract does not extend to a wide range of financial contracts and financial institutions. Banks or other financiers are free to rely on a cross-default clause to terminate or accelerate a loan agreement. By contrast, non-financial suppliers of goods and services – mostly trade creditors – are not able to terminate a contract based on a cross-default if the event of default occurred pre-insolvency and the right to terminate was not exercised before the opening of the relevant procedure. However, if the default occurs after the commencement of such a procedure (e.g. non-payment for goods supplied after the opening of an insolvency proceeding), the law does not affect termination and other similar rights. In practice, the suspension of cross-default clauses during the insolvency procedure can incentivise creditors to exercise their termination rights as soon as signs of financial distress appear. This could be detrimental to the very goal of promoting restructuring, underpinning the CIGA.

The CIGA and English insolvency law generally do not establish a structured process in which the debtor or the trustee must decide within a specified time frame whether to assume, reject or assign an executory contract (as found in US law, see below). Neither does it law down an obligation to provide security for new obligations arising during the insolvency procedure (as found in Dutch law, see below). Instead, the law states that suppliers cannot condition any future supply of goods and services on the payment of outstanding charges for supplies made before the opening of the insolvency procedure.[82] Hence, suppliers cannot terminate the contract or demand payment for past debts as a condition for future supplies. There is an exception in cases of hardship, where the court may approve the

81 Insolvency Act 1986, Section 233B(4).
82 Insolvency Act 1986, Section 233B(7).

termination of a contract causing hardship.[83] Termination is also permitted with the consent of an office-holder.[84] The supplier should also be able to terminate the contract if a post-insolvency default occurs (e.g. non-payment of post-insolvency claims), giving rise to a new event of default. It is worth noting that financial creditors are excluded from the scope of these provisions, while trade creditors – often unsecured and facing the risk of losing all the value of their claims – are targeted. This different treatment is problematic and raises fairness concerns.[85]

9.4.2 The USA: contract assumption and de-acceleration

The right of a creditor to terminate a contract that is favourable to the debtor may go against the power of the debtor in possession or a trustee, appointed by the court, to assume or reject an executory contract. The US Bankruptcy Code states that "the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor."[86] Under US law, the bankruptcy estate does not automatically become a party to an executory contract. This contract remains in limbo until a representative of the bankruptcy estate makes a decision whether to assume or reject it. If the debtor chooses to assume the contract, any outstanding defaults must be fully cured, and the counterparty must be provided with adequate assurances of continued performance. Any ongoing liabilities under the contract become payable with administrative priority, ensuring that the counterparty is likely to be kept whole.[87] If the contract is rejected, such rejection leads to a breach of contract, effective as of the petition date. As a result, the counterparty acquires a claim for damages against the debtor, which can be compromised in a reorganisation plan.[88] In essence, the debtor facing financial distress has a choice between continuing to perform under the contract or opting for a breach.

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83 Insolvency Act 1986, Section 233B(5)(c). Reliance on the financial hardship exclusion may be difficult due to a high threshold. See further L. Hotton, J. Norris, UK Corporate Insolvency and Governance Act: effects on ipso facto clauses, Butterworths Journal of International Banking and Financial Law, September 2020, p. 552, noting that "[i]t is arguable that the measures go too far to the detriment of suppliers". A similar hardship provision can be found in Singapore (IRDA, sec. 440(4)). For the interpretation of "significant financial hardship" in the Canadian context, see *Toronto-Dominion Bank v. Ty (Canada) Inc*, 42 CBR (4th) 142, 2003 CanLII 43355.

84 Insolvency Act 1986, Section 233B(5)(a).

85 J. Sarra, J. Payne, S. Madaus, The Promise and Perils of Regulating Ipso Facto Clauses, International Insolvency Review, Vol. 31, 2022, p. 71.

86 11 U.S. Code § 365(a).

87 S. Paterson, A. Walters, Selective Corporate Restructuring Strategy, Modern Law Review, Vol. 86, 2023, p. 450.

88 *Mission Product Holdings, Inc. v. Tempnology, LLC*, 139 S.Ct. 1652, 1661 (U.S., 2019) ("Rejection of a contract – any contract – in bankruptcy operates not as a rescission but as a breach").

The right to assume an executory contract "preserves valuable contracts for the benefit of the estate."[89] Assumption is therefore usually a choice for the above-market contracts. This choice only applies to executory contracts. Non-executory contracts are regarded either as assets (constituting a debtor's claim against a third party) or liabilities (representing a debt owed to a third party), which must be disclosed together with other interests. They are not subject to assumption, rejection, or the ride-through doctrine.[90]

US bankruptcy law differentiates between defaulted and non-defaulted executory contracts. Thus, "[i]f there has been a default in an executory contract […] of the debtor, the trustee may not assume such contract or lease unless […] the trustee […] cures, or provides adequate assurance that the trustee will promptly cure, such default […]."[91] This rule applies only if there has been a default, whether pre- or post-petition, other than the insolvency-triggered (i.e. ipso facto) default.[92] It commits the estate to full performance under the contract, including curing any defaults, in exchange for the continuation of the counterparty's duties. The counterparty is provided with the benefit of its economic bargain and acquires an administrative priority claim against the estate on the assumed contract. Be it as it may, outside bankruptcy, the defaulted debtor might not be entitled to cure the default and "restore" a valuable contract. Why does bankruptcy law change this? Jackson suggests that the reason could be debtor passivity or debtor indifference – the debtor who knows that he is insolvent may not care about defaults and what happens with his assets.[93]

From the wording of the US Bankruptcy Code, it is not entirely clear whether, as a condition to assuming an executory contract with a cross-default clause, the debtor must cure a default of an obligation arising from another (separate) contract. If the cross-default provision is enforceable, the assumption of a valuable contract will depend on the performance under all contracts connected through a cross-default – a very demanding requirement. In the case of *United Air Lines, Inc., v. U.S. Bank Trust.*, the court permitted the assumption of a contract despite the default on another contract

89 E.J. Janger, J.A.E. Pottow, Implementing Symmetric Treatment of Financial Contracts in Bankruptcy and Bank Resolution, Brooklyn Journal of Corporate, Financial & Commercial Law, Vol. 10, 2015, p. 163.

90 *ASARCO, L.L.C. v. Montana Res., Inc.*, 858 F.3d 949, 959 (5th Cir. 2017), noting that "[e] xecutory contracts that are not assumed or rejected 'ride through' the bankruptcy unaffected by the bankruptcy proceedings." Thus, non-rejected prepetition executory contracts "ride though" the bankruptcy and continue to exist and be binding thereafter.

91 11 U.S. Code § 365(b). The law does not define "adequate assurance" and what constitutes such assurance will depend on the facts and circumstances of each case. *In re Patriot Place, Ltd.*, 486 B.R. 773, 801 (Bankr. W.D. Tex. 2013).

92 11 U.S. Code § 365(b)(2).

93 T.H. Jackson, The Logic and the Limits of Bankruptcy Law, HUP, 1986, p. 118.

linked to the first contract by a cross-default clause. Refusing to give effect to this clause, it noted that the policy underlying the US Bankruptcy Code was to assist in the debtor's rehabilitation or liquidation by permitting the assumption of valuable contracts. According to the court, this purpose:

> could certainly be frustrated if a debtor were required to perform under unrelated contracts as a condition for assumption. For example, a particular supplier of goods to the debtor might provide that its supply contract would terminate upon the debtor's breach of any similar agreement with other specified suppliers. Such a "pay all" requirement could effectively serve as a proxy for the debtor's insolvency, and, in bankruptcy, it would require the debtor to pay the pre-petition claims of the specified suppliers as a condition for assumption […]. However, the cross-default rule addresses this problem by preventing a debtor from being required to perform contracts substantially unrelated to the one sought to be assumed.[94]

Thus, even though cross-default clauses differ from ipso facto clauses, and unlike the latter, they are not invalidated by the express provisions of law, the court recognised that they may have similar effects and inhibit the debtor's restructuring. It explained that any other interpretation would allow the non-debtor party to impose on the estate "the costs of substantially unrelated agreements."[95] The notions of "substantial relation" or "economic interdependence" between separate agreements play an important role in determining whether a cross-default provision should be enforced.[96] In the earlier case of *In re Kopel*, it was established that courts refused to enforce cross-default clauses in cases where contracts were not interrelated. The court held that "where the non-debtor party would have been willing, absent the existence of the cross-defaulted agreement, to enter into a contract that the debtor wishes to assume, the cross-default provision should

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94 *United Air Lines, Inc., v. U.S. Bank Trust, N.A.* 346 B.R. 456 (Bankr. N.D. Ill. 2006), denying the enforcement of a cross-default provision in the lease of airport terminal space and a separate agreement to make payments on certain bonds.

95 Ibid. For discussion of this case and the role of substantial connectedness, see A. Coles-Bjerre, Ipso Facto: The Pattern of Assumable Contracts in Bankruptcy, New Mexico Law Review, Vol. 40, 2010, p. 105, concluding that "courts have, in effect, extended the Code's invalidation of ipso facto clauses […] by invalidating cross-default clauses that bear an insufficient relationship to the contract that the debtor is seeking to assume." On the subject, see also A.N. Resnick, B.E. Scheler, From the Bankruptcy Courts: The Effect of a Cross-Default Provision on the Ability to Assume an Executory Contract or Unexpired Lease, Uniform Commercial Code Journal, Vol. 32, 2000, pp. 338-343.

96 See *Lifemark Hospitals, Inc. v. Liljeberg Enters. (In re Liljeberg Enters.)*, 304 F.3d 410 (5th Cir. 2002); *The Shaw Group, Inc. v. Bechtel Jacobs Co., LLC (In re The IT Group, Inc.)*, 350 B.R. 166 (Bankr. D.Del. 2006); *In re Szenda*, 406 B.R. 574, 581 (Bankr. D. Mass. 2009), holding that the agreements in question were not "part and parcel of the same bargain, regardless of the inclusion of the cross-default clause." *In re Kline*, 2013 WL 587339 (Bankr. D. Or. 2013), noting that the presence of cross-default provisions "is not enough in itself to integrate agreements that are otherwise separate or severable."

not be enforced."[97] It noted that such enforcement may be seen as a way to extract priority under an unrelated contract and maximise returns for a specific creditor.

There is an important exception to the assumption right; it does not cover executory contracts "to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor."[98] This exception is aligned with the carve out from an ipso facto ban, discussed above. Both address a specific fear that a lender would be forced to extend new credit through the assumption by the debtor of a pre-petition financial agreement. Contracts to (i) make loans, (ii) extend debt financing, (iii) extend financial accommodations, or (iv) issue a security of the debtor are variations of the types of contracts that raise this concern.[99] Therefore, a lender under a revolving credit facility would not be forced to finance the bankrupt. Importantly, since the new credit benefits from the administrative priority status, the exception regarding the assumption of financial agreements protects the interests of the entire body of unsecured creditors. US courts strictly construe the scope of this exception and do not apply it to contracts involving the provision of goods or services that have incidental financial accommodations or extensions of credit.[100] However, they do classify surety bonds and guarantee agreements as "financial accommodations", thereby exonerating them from the assumption.[101] If the debtor wishes to attract cash to finance restructuring or extend security for such financing, it must comply with the special rules aimed at balancing the interests of different stakeholders in a bankruptcy case – DIP financing rules (see section 12.2.3.).[102]

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97 *Kopel v. Campanile (In re Kopel)*, 232 B.R. 57, 66 (Bankr. E.D.N.Y. 1999).

98 11 U.S. Code § 365(c)(2).

99 See *In re Teligent, Inc.*, 268 B.R. 723 (Bankr. S.D.N.Y. 2001) for a detailed account of the Congress' intent behind 11 U.S. Code § 365(c)(2).

100 Courts have held that a credit card merchant agreement, letters of credit and a dealership agreement were not financial accommodations. See *In re United Airlines, Inc.*, 368 F.3d 720 (7th Cir. 2004); *Rafool v. Evans*, 497 B.R. 312 (C.D. Ill. 2003); *In re Jonesboro Tractor Sales, Inc.*, 619 B.R. 223 (Bankr. E.D. Ark. 2020).

101 *In re Wegner Farms Co.*, 49 B.R. 440 (Bankr. D. Iowa 1985); *In re Thomas B. Hamilton Co., Inc*. 969 F.2d 1013, 1019 (11th Cir. 1992) ("courts have held that loan commitments, guaranty and surety contracts, and other contracts the principle purpose of which is to extend financing to or guarantee the financial obligations of the debtor are contracts to extend financial accommodations."). Also, *In re Falcon V, LLC*, 620 B.R. 256 (Bankr. M.D. La. 2020).

102 11 U.S. Code § 364, governing post-petition extension of credit, providing for specific incentives and safeguards. Given the special framework for post-petition financing, courts have ruled that loan agreements are non-assumable even if the lender has "voluntarily" consented to make a post-petition extension of credit. *In re Cardinal Industries, Inc.*, 146 B.R. 720 (Bankr. S.D. Ohio 1992); *In re Sun Runner Marine, Inc.*, 945 F.2d 1089, 1093 (9th Cir.1991), holding that § 365(c)(2) unambiguously prohibits the assumption of financial accommodation contracts, regardless of the consent of the non-debtor party.

Nevertheless, the US Bankruptcy Code contains special rules that permit a plan to reverse a contract acceleration – contract de-acceleration, including with respect to a loan agreement. As a background, US law allows the debtor to leave a class of creditors out. Creditors in such an unimpaired class are presumed to have accepted the reorganisation plan.[103] A class of claims is treated as unimpaired if the plan, irrespective of any contractual provision that entitles the holder of a claim to demand or receive accelerated payment of such claim after the occurrence of a default, (i) cures any such default (other than a default caused by an ipso facto clause that needs no cure), (ii) reinstates the maturity of a claim as it existed before the default, and (iii) compensates the claim holder for damages incurred as a result of any reasonable reliance by such holder on this contractual provision.[104]

This provision creates a powerful weapon that allows a Chapter 11 plan to de-accelerate and reinstate a pre-petition obligation – a technique sometimes referred to as "cram-up". It permits the debtor to cure any defaults, whether pre- or post-petition, nullifying any consequences of these defaults and returning the parties to pre-default conditions. This applies even if a senior creditor has obtained a foreclosure judgment, but the collateral has not yet been sold. As a result, the debtor is relieved of the burdens of contract acceleration clauses and can maintain the original terms. At the same time, the creditor receives the benefit of his original bargain.

Thus, while the trustee, debtor in possession, or a reorganisation plan cannot assume a loan contract and force the lender to continue financing the debtor (new credit), the plan could de-accelerate the granted loan. Consequently, it may prevent "a party from using a contractual right of acceleration to terminate a valuable contract of the debtor in circumstances where the debtor is willing to cure past defaults and perform under the original terms of the agreement."[105] The question is whether "curing any defaults" includes cross-defaults. In this respect, in view of the courts' attitude to cross-default clauses in the assumption context, a similar approach is warranted in the de-acceleration context. If contracts are not substantially connected and are not economically interdependent, the debtor should not be required to cure all cross-defaulted contracts in order to de-accelerate the loan. Any other solution could render the de-acceleration right illusory. That said, the case law on this issue is rather limited. This may be explained by

103 11 U.S. Code § 1126(f).
104 11 U.S. Code § 1124(2).
105 Collier on Bankruptcy, 16th edn, 2022, Vol. 7, ¶ 1124.04[5].

the limited appeal of de-acceleration,[106] creditors' unwillingness to enforce cross-defaults and risk their reputation, and the proliferation of covenant-light loans.[107]

In sum, under US law, cross-default clauses are not per se invalid. However, they are inherently suspect due to their potential to hamper a debtor's reorganisation.[108] Courts carefully scrutinise the facts and circumstances of relevant agreements. This scrutiny is especially relevant in the context of assumption and de-acceleration of contracts, which are subject to the requirement of curing any defaults, except ipso facto defaults. If the cross-defaulted contracts form a single, integrated or indivisible transaction, there are good reasons to enforce a cross-default clause, since doing otherwise would be contrary to the parties' legitimate expectations and their economic interests. Yet if the cross-defaulted contracts are not interrelated and economically interdependent, courts may refuse to enforce a cross-default clause.

9.4.3 The Netherlands: suspension of termination rights during "cooling-off period"

The right of parties to include a cross-default clause in their contract is based on the principle of freedom of contract. Generally, Dutch law of obligations (*verbintenissenrecht*) is dispositive (*aanvullend recht*) and not imperative law (*dwingend recht*).[109] Therefore, unless law mandates otherwise, parties are free to shape their relations as they wish. This also means that parties are free to deviate from statutory regulation of defaults (e.g. when it comes to a notice of default).[110] While cross-default clauses are generally considered to be enforceable, their enforceability may be limited by mandatory rules, such as those introduced by the WHOA. According to Article 373(4) Fw,

> If a cooling-off period has been ordered in accordance with Article 376, during that period, any default by the debtor that has occurred prior to the cooling-off period does not constitute a ground for the amendment of any commitment or obligation in respect to the debtor, for the suspension of the performance of any commitment in respect of the debtor, or for the termination of any contract concluded with the debtor to the extent that security has been provided for the performance of new obligations arising during the cooling-off period.

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106 T.H. Jackson, The Logic and Limits of Bankruptcy Law, Beard Books, 2001, p. 37, noting that a de-acceleration right "is likely to be exercised principally against secured creditors with below-market loans".

107 A.J. Casey, The New Corporate Web: Tailored Entity Partitions and Creditors' Selective Enforcement, The Yale Law Journal, Vol. 124, 2015, p. 2680.

108 *In re Cumberland Corral, LLC*, 2014 Bankr. LEXIS 936 (Bankr. M.D. Tenn. Mar. 11, 2014).

109 Asser/Sieburgh 6-III 2022/316; M.A. Loth, Dwingend en aanvullend recht (Mon. BW A19), Wolters Kluwer, 2009.

110 Asser/Sieburgh 6-I 2020/387.

The reorganisation value, also referred to as a *going concern* surplus, may diminish if normal business operations come under pressure in connection with the restructuring. Article 373(4) Fw addresses a situation where a party to an agreement refuses to continue relations with the debtor due to a default. It aims, on the one hand, to guarantee that the goal of a cooling-off (a stay) is not frustrated, and on the other hand, to ensure that the interests of a counterparty that has already been confronted with a debtor's default are sufficiently safeguarded.[111] Unlike ipso facto clauses, which are inoperative, default-triggered clauses are valid, but their effectiveness is suspended or "frozen" during the cooling-off period – four months with a possible extension of no more than four months – a total of eight months.[112] The language of the discussed provision is broad enough ("any default by the debtor") to encompass cross-defaults. The following paragraphs summarise the key features of Dutch law in this respect.

First, unlike section 233B(4) of the Insolvency Act 1986, which has limited material scope, Article 373(4) Fw is broad in scope and captures almost all agreements, including loan agreements. One of the exceptions covers financial framework agreements, such as the ISDA Master Agreement and the Global Master Repurchase Agreement (GMRA). Although the original text of the WHOA does not make this exception explicit, during the legislative process,[113] it was clarified that if protection offered by close-out netting and security over financial collateral is diminished, the court shall grant the counterparty leave to enforce security over financial collateral provided under a financial collateral arrangement.[114] The Act Transposing the Restructuring Directive in the Netherlands (in force since 1 January 2023) clearly excludes these agreements from the WHOA's scope and, therefore, from its limitations on the enforceability of certain contract terms.[115]

111 This balance is in line with Article 7(4) of the Restructuring Directive, which aims to strike a balance between restricting parties' termination and acceleration rights related to a default, on the one hand, and preventing unfair prejudice caused to such creditors as a result of the imposed restriction, on the other hand.

112 Article 376 Fw. For a similar rule, see StaRUG, Article 55(1).

113 *Kamerstukken I* 2019/20, 35 249, C (MvA) p. 7-11.

114 Nijkamp and Steeg argue that the need to obtain leave from a court may be inconsistent with Article 4(4)(d) and 4(5) of the Financial Collateral Directive and with Article 241d Fw. D.D. Nijkamp and R.W.K. Steeg, How certain elements of the Dutch scheme may (or may not) affect ISDA Master Agreements, FIP, No. 1, 2021, p. 55; S. Renssen, De herijking van het faillissementsrecht. De WHOA (Recht & Praktijk, nr. InsR17), Deventer: Wolters Kluwer 2021. On the ISDA Master Agreement, see W.A.K. Rank, Een paarlen jubileum voor de ISDA Master Agreement: 30 jaar contractszekerheid voor OTC-derivaten, *FR*, afl. 4, 2017, p. 117-128.

115 Implementatiewet richtlijn herstructurering en insolventie (Stb. 2022, 491); Besluit van 5 december 2022 tot vaststelling van het tijdstip van inwerkingtreding van de Implementatiewet richtlijn herstructurering en insolventie (Stb. 2022, 492), making amendments to Article 369 Fw.

Second, the Dutch Bankruptcy Act distinguishes between a default that occurred before the cooling-off period (*afkoelingsperiode*)[116] and a default that took place thereafter. Notably, the Act Transposing the Restructuring Directive clarifies that the timing of the default – before or during the cooling-off period – is not important. What matters is whether the default relates to a pre-cooling-off period commitment. Only this default is covered by Article 373(4) Fw, which aims to facilitate negotiations over a restructuring plan and supports the debtor's operation during such negotiations. If the debtor defaults on new, post-cooling-off period obligations, the creditor can rely on the contract to amend, suspend or terminate it. This does not mean that the creditor is entitled to enforce his claim; the enforcement is stayed during a cooling-off period (Article 376 Fw).

Figure 9. Limitations concerning (cross-)defaults in UK, US and Dutch law

	UK	**USA**		**Netherlands**
Relevant limitation	Suspension of termination rights during the insolvency period	Assumption	De-acceleration	Suspension of termination and amendment rights during a cooling-off period
Contracts covered	Contracts for the supply of goods or services, unless the counterparty is a person involved in financial services (e.g. a bank)	Executory contracts and unexpired leases, unless exempt (e.g. contract to make a loan or extend other debt financing)	All contracts (e.g. including loan agreements), unless exempt (e.g. qualified financial contracts)	Any commitment or obligation, unless exempt (e.g. financial framework agreements)
Special conditions applied	N/A. Termination possible in case of hardship or with consent of an office holder	Cure any defaults, compensate for any actual pecuniary loss, adequate assurance of future performance	Cure any defaults, reinstate maturity of a claim, compensate any damages	Security for new obligations, arising during a cooling-off period
Cross-defaults covered	Yes	Yes, if relevant obligations are interrelated and economically interdependent		Yes

116 A cooling-off period is similar to a stay. For discussion of insolvency stays, see Chapter 11 of the book.

Third, protection against default-triggered contract termination or alteration is premised on the obligation to provide security for the performance of new obligations under the contract, arising during the cooling-off period.[117] This requirement can be met, inter alia, by immediate fulfilment of these obligations (cash on delivery).[118] Insofar as security is insufficient, the creditor's right to amend or terminate the contract or to suspend performance under it does not lapse. When compared to US law, Dutch law (just like English law) does not mandate that the pre-cooling-off defaults are cured for the remaining obligations to stay in force. Therefore, the problem of the "pay all" commitment under substantially unrelated agreements, existing in the USA, is avoided.

To sum up, the Dutch Bankruptcy Act "freezes" the enforceability of (cross-) default clauses for the duration of a cooling-off period. What happens after its expiration? Given that default-triggered termination rights are valid and only temporarily suspended, upon the expiration of a cooling-off period, the protection of 373(4) Fw ceases.[119] This means that a default may "survive" the WHOA scheme and should be addressed when negotiating and voting on it.

9.5 Insolvency and Ex-post Effects of Ipso Facto and Cross-Default Clauses in a Group Context

In Chapter 6, we stressed that intercompany guarantees increase group interdependence and interconnectedness. We also mentioned that they may complicate group restructuring. Similar observations can be made regarding ipso facto and cross-default clauses, which connect different companies within the same enterprise group.

Just like cross-guarantees, cross-entity ipso facto and cross-default clauses impose correlation between separate legal entities and increase their dependence on the performance of the whole group. Imagine that a creditor is entitled to terminate or accelerate a contract with Company A for the sole reason that Company B becomes financially distressed or files for insolvency, or defaults on its obligation to someone else. The activation of ipso facto and cross-default clauses could create a chain reaction, negatively impacting Company A and potentially the entire enterprise. In other words, contractually-created correlation can quickly escalate into a group-wide contagion – the infamous domino effect. As a result of contract acceleration attributed to a cross-default, Company A may become unable to perform unrelated obligations owed to other parties. Similarly, reliance on an ipso

117 MvT, *Kamerstukken II* 2018/19, 35249, 3.

118 R. van den Sigtenhorst, in: T&C Insolventierecht, commentaar op art. 373 Fw. For a similar provision in German law, see StaRUG, section 55(3).

119 Ibid. (Sigtenhorst).

facto clause to invoke the amendment, acceleration or termination of a contract can increase liquidity pressure, lead to defaults and cross-defaults on various obligations, and even destroy the prospects of successful restructuring.[120] In practice, the willingness of a creditor to pull the trigger and terminate or accelerate the contract, or abstain from the enforcement and agree to new contract terms (e.g. extension of maturity dates) may depend on multiple factors. Among them are the likely spread of contagion across the enterprise group, the existence of a security interest benefiting the creditor, reputational concerns, the viability of the group's business, trust in the debtor's management, information availability and wider market dynamics and competitive pressures.

The threat of ipso facto and cross-default clauses weakens the negotiation power of the debtor and may encourage holdout behaviour by a counterparty – a creditor that can rely on a cross-default or ipso facto clause. Importantly, the risk of termination of a valuable contract, arising from the exercise of a contractual right, is capable of deterring the debtor from seeking formal restructuring and early help.[121] The debtor or its affiliate may postpone debt restructuring due to the risk of causing a group-wide enforcement. As a result, the management of the debtor or of another group entity, linked to the debtor through a contract clause, may be reluctant to take early steps to address financial difficulties and prevent insolvency.

9.6 Conclusion

This chapter examines two types of clauses, which are prevalent in financial transactions, such as syndicated loan, bond, derivatives, repos and securities lending documentation – ipso facto and cross-default clauses. These clauses often connect several entities within an enterprise group. For example, an "event of default" that permits the creditor to amend, terminate or accelerate the contract may refer to a fact or occurrence relating to another group member (e.g. insolvency filing, default on a payment obligation).

As for the rationale and ex post effects of ipso facto and cross-default clauses, they serve risk control and risk mitigation functions. They may seek to deter a breach (given the gravity of its consequences), discipline

120 F. Robert-Tissot, The Effects of a Reorganization on (Executory) Contracts: A Comparative Law and Policy Study [United States, France, Germany and Switzerland]', III Bronze Medal Winner Paper, 2012, p. 24, finding that the enforcement of ipso facto clauses could be inefficient "for it would only advantage the non-debtor, but cause significant losses for the other creditors."

121 B. Wessels, S. Madaus, Rescue of Business in Insolvency Law. Instrument of the European Law Institute, 2017, p. 395, noting that "any restructuring is doomed if the commencement of proceedings may prompt financial creditors to accelerate the repayment of credit or licensors and lessors to terminate contracts."

the debtor and other group companies, and allow the creditor to terminate, accelerate or withhold future performance upon the first signs of financial distress, thereby responding to increased counterparty risk and contributing to loss reduction. When supplemented by information covenants, they could improve overall creditor oversight and provide the creditor with additional leverage in negotiations with the debtor or a group of debtors. These are all valid commercial reasons that should be taken seriously. Besides, since in large-scale commercial lending and other financial contracts, parties tend to have equal bargaining power, no concerns about unfairness of contract terms arise. However, the ex post effects of ipso facto and cross-default clauses are troubling. It has been shown that their enforcement might result in the loss of value, should a valuable contract be terminated or accelerated. They reduce the bargaining power of the debtor, discourage early crisis responses and complicate restructuring efforts. In a group context, they can also contribute to the spread of contagion within the group.

The issue at stake is freedom of contract and its potential conflict with the goals of insolvency law. A creditor has contracted for an option to terminate, amend, or accelerate a contract. One can argue that the creditor (similar to a secured creditor acquiring a security interest) has already paid for this option when agreeing to contract terms. The question therefore is whether and under which circumstances limiting party autonomy is justified. From an overview of English, US and Dutch law (and briefly considering other legal systems), a general observation can be made that in recent years, freedom of contract has been increasingly curtailed to serve the principles of insolvency law, specifically estate value preservation and maximisation, and equal treatment of creditors. Even jurisdictions that have historically been the bastions of freedom of contract and offered limited tools to support full-scale financial and operational reorganisation (e.g. the UK) have introduced restrictions on ipso facto and (cross-)default-triggered clauses.

The very normative foundation of insolvency law is centred around limiting individual freedom for the benefit of creditors as a class and in the public interest.[122] This chapter demonstrates that many legal systems impose substantial restrictions on ipso facto clauses – provisions that entitle a creditor to unilaterally terminate, amend or accelerate the contract and refuse future performance due to the debtor's insolvency filing, its deteriorating financial condition, or another insolvency-linked event. Such interference with party autonomy is typically explained by the desire to advance

122 T.H. Jackson, Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain, The Yale Law Journal, Vol. 91, 1982, p. 862, noting that in the absence of a collective system, creditors would act out of immediate self-interest and engage in a race to use individualistic remedies, "even though it is not in the creditors' collective interest to use them at all." Also H. Rajak, Insolvency Law: Theory and Practice, Sweet & Maxwell, 1993, p. 86.

restructuring or the need to protect the going concern value of the debtor's business.[123] As Jackson points out, these clauses destroy "the collective weal in bankruptcy".[124]

The scope of restrictions varies from one country to another and may depend on the type of proceeding or contract (see figure 7). The prohibition of ipso facto clauses in the UK applies to most insolvency procedures but altogether excludes financial contracts, including loans and the provision of guarantees. Similarly, the US bankruptcy law's ban on ipso facto clauses does not apply to many financial contracts, including a contract to make a loan. Dutch law does not carve out loan agreements from the limitations on the enforceability of ipso facto clauses but is rather restrictive in terms of the procedures explicitly covered (i.e. WHOA schemes only).

Another observation to be made is that cross-default clauses triggered by a default on an obligation are treated differently from ipso facto clauses. They are generally held to be valid, as they do not fall under the ipso facto clause ban. However, some less far-reaching limitations may still apply to them (see figure 9). For example, both English and Dutch law suspend a default-triggered termination right for the duration of an insolvency proceeding and a cooling-off period, respectively. In principle, this limitation applies to cross-defaults. Yet, as with ipso facto clauses, English law does not touch termination rights in most financial contracts.

In contrast to English and Dutch law, US bankruptcy law offers a well-structured process for termination, assumption, and de-acceleration of contracts in bankruptcy. It grants special rights to the trustee or debtor in possession to assume an executory contract – a contract in which both parties continue to have ongoing obligations to each another, subject to the cure requirement. The assumption right does not extend to many financial contracts, including a contract to make a loan or extend other debt financing. Hence, financing obligations cannot be assumed, and a financier (e.g. a bank) cannot be forced to finance the bankrupt company, even if any default is cured. Nevertheless, the debtor can de-accelerate a defaulted loan agreement, provided that all defaults are cured. This de-acceleration option is attractive and is likely to be exercised to preserve the below-market loans, as ultimately the reinstated loan must be repaid in full. The question arises whether all cross-defaults should be cured before the debtor can assume or reinstate the contract. In this respect, US courts have considered cross-default clauses to be "inherently suspect". They did not require debtors to cure cross-defaulted contracts if such contracts were not interrelated and economically interdependent.

123 J. Sarra, J. Payne and S. Madaus, The Promise and Perils of Regulating Ipso Facto Clauses, International Insolvency Review, Vol. 31, 2022, p. 67.

124 See T.H. Jackson, The Logic and Limits of Bankruptcy Law, Beard Books, 2001, p. 43.