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IPSO FACTO CLAUSES IN CONSTRUCTION CONTRACTS

An Analysis of Section 440 of the Insolvency, Restructuring and Dissolution Act 2018

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Construction contracts commonly provide that a contractor's insolvency or the commencement of restructuring proceedings in respect of the contractor may give rise to the employer's entitlement to exercise certain rights under the contract, including the right to terminate the contractor's employment. Most construction contracts also require the contractor to furnish an on-demand performance bond, which the employer can call on without proof of default. This arguably allows the employer to call on the on-demand performance bond in the event that the contractor is undergoing restructuring proceedings or is insolvent at the material time. This article explores the impact of s 440 of the Insolvency, Restructuring and Dissolution Act 2018 ("IRDA") in respect of the aforementioned scenarios, and discusses some practical tips which can be considered to navigate s 440 of the IRDA.

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I. Introduction

1 Rising labour and material costs especially in the aftermath of the COVID-19 pandemic, coupled with the tapering of COVID-19 relief measures, have resulted in an increasing number of construction companies undergoing insolvency or restructuring proceedings in Singapore.[2]

2 The Insolvency, Restructuring and Dissolution Act 2018[3] ("IRDA"), which came into force on 30 July 2020, puts in place mechanisms to assist and support companies undergoing restructuring proceedings. Amongst them, s 440 of the IRDA was introduced to impose restrictions on the enforcement of *ipso facto* clauses, which are clauses allowing a contractual party to modify or terminate a contract upon the occurrence of specified events of default, such as the commencement of restructuring or insolvency proceedings.

3 Given that it is not uncommon for construction contracts to provide that a contractor's insolvency or the commencement of restructuring proceedings alone are events giving rise to the employer's entitlement to exercise rights under the contract (for instance, to terminate the contractor's employment), it is a timely juncture to examine the impact of s 440 of the IRDA in restricting the employer's reliance on *ipso facto* clauses.

4 This article (a) sets out an overview of s 440 with a summary of key points to note;[4] (b) discusses the impact and application of s 440 in the context of two commonly used standard forms for projects in Singapore, with respect to two scenarios which commonly feature in construction projects, namely, the

2 Nasyrah Abdul Rohim & Darrelle Ng, "More Construction Firms Going Bust After Pandemic, Say Liquidators", *CNA* (22 April 2024) <https://www.channelnewsasia.com/singapore/construction-building-contractors-bust-debts-after-pandemic-liquidators-4282961> (accessed 8 July 2024). See also Asia Infrastructure Solutions, *Construction Cost Review* (Issue 4, Fourth Quarter 2023) <https://www.asiainfrasolutions.com/wp-content/uploads/2024/04/AIS-Construction-Cost-Review-4Q2023.pdf> (accessed 8 July 2024).

3 2020 Rev Ed.

4 See paras 5 and 6 below.

employer's termination of the contractor's employment and the employer's call on an on-demand performance bond;[5] and (c) discusses some practical tips which can be considered to navigate s 440 of the IRDA.[6]

II. Overview of s 440 of IRDA

5 For reference, s 440 of the IRDA is reproduced below in full:

> **Certain contractual rights limited**
>
> **440.**—(1) No person may, at any time after the commencement, and before the conclusion, of any proceedings by a company —
>
> (*a*) terminate or amend, or claim an accelerated payment or forfeiture of the term under, any agreement (including a security agreement) with the company; or
>
> (*b*) terminate or modify any right or obligation under any agreement (including a security agreement) with the company,
>
> by reason only that the proceedings are commenced or that the company is insolvent.
>
> (2) Nothing in this section is to be construed as —
>
> (*a*) prohibiting a person from requiring payments to be made in cash for goods, services, use of leased property or other valuable consideration provided after the commencement of the proceedings; or
>
> (*b*) requiring the further advance of money or credit.
>
> (3) Any provision in an agreement that has the effect of providing for, or permitting, anything that, in substance, is contrary to this section is of no force or effect.
>
> (4) On an application by a party to an agreement, the Court may declare that this section does not apply, or applies only to the extent declared by the Court, if the applicant satisfies the Court that the operation of this section would likely cause the applicant significant financial hardship.

5 See paras 7–24 below.
6 See paras 25–33 below.

(5) Subsection (1) does not apply in respect of any legal right under —

(*a*) any eligible financial contract as may be prescribed;

(*b*) any contract that is a licence, permit or approval issued by the Government or a statutory body;

(*c*) any contract that is likely to affect the national interest, or economic interest, of Singapore, as may be prescribed;

(*d*) any commercial charter of a ship;

(*e*) any agreement within the meaning of the Convention as defined in section 2(1) of the International Interests in Aircraft Equipment Act 2009; or

(*f*) any agreement that is the subject of a treaty to which Singapore is party, as may be prescribed.

(6) In this section —

'company' means any corporation liable to be wound up under this Act, but excludes such company or class of companies as the Minister may by order in the Gazette prescribe;

'essential service' has the meaning given by section 2(1) of the Cybersecurity Act 2018;

'national interest' includes national defence, national security, public security and the maintenance of any essential service;

'proceedings' means any proceedings arising from —

(*a*) any application under section 210(1) of the Companies Act 1967 for the approval of the Court in relation to any compromise or arrangement between a company and its creditors or any class of those creditors;

(*b*) any application under section 71 for the approval of the Court in relation to any compromise or arrangement;

(*c*) any application for an order under section 64 or 65;

(*d*) any application for a judicial management order under section 91; or

> (*e*) the lodgment of a written notice of the appointment of an interim judicial manager under section 94(5)(*a*).

6 For present purposes, the key features of s 440 of the IRDA can be summarised as follows:

(a) First, s 440 only applies to contracts entered into after 30 July 2020. As an aside, such contracts would have been entered into post COVID-19 and contractors are likely to have priced in the increase in costs following the pandemic.

(b) Second, s 440 restricts a contracting party who purports to (i) terminate, amend, claim an accelerated payment or forfeit a term under the agreement or (ii) terminate or modify any right or obligation under any agreement, by reason *only* that "proceedings" have been commenced or the company is "insolvent". In other words, the aforementioned actions are permissible if they can be justified on grounds other than that "proceedings" have been commenced against the company, or that the company is insolvent.

(c) Third, "proceedings" for the purpose of s 440 refers to proceedings for judicial management (both court-supervised and out-of-court judicial management)[7] and schemes of arrangement (including applications for scheme moratorium,[8] related-party scheme moratorium,[9] as well as pre-packaged schemes of arrangements)[10] (each a "s 440 Proceeding", and collectively the "s 440 Proceedings"). Hence, s 440 applies upon the commencement of any s 440 Proceeding (subject to satisfaction of the other requirements under s 440).

(d) The following do not fall within the definition of "proceedings" and would not on their own trigger s 440 of the IRDA:

7 Insolvency, Restructuring and Dissolution Act 2018(2020 Rev Ed) s 94.
8 Insolvency, Restructuring and Dissolution Act 2018 (2020 Rev Ed) s 64.
9 Insolvency, Restructuring and Dissolution Act 2018 (2020 Rev Ed) s 65.
10 Insolvency, Restructuring and Dissolution Act 2018 (2020 Rev Ed) s 71.

(i) winding-up proceedings (be it voluntary winding up or compulsory winding up); and

(ii) the appointment of receivers or receivers and managers in respect of the contractor's assets.[11]

(e) Fourth, it is observed that there is presently no pronouncement by the Singapore courts on what "insolvency" means in the context of s 440 of the IRDA. The Singapore Court of Appeal in *Sun Electric Power Pte Ltd v RCMA Asia Pte Ltd*[12] clarified that the cash flow test should be the sole determinative test under s 125(2)(*c*) of the IRDA to determine whether a company is unable to pay its debts such as to warrant a winding-up order.[13] However, absent any pronouncements on the applicable insolvency test in respect of s 440, there may still be room for the balance sheet test to apply in this context.[14]

(f) Fifth, s 440(4) provides an avenue for a contracting party to apply to court for a declaration that the provision does not apply in whole or in part. The court has to be satisfied that s 440 will cause the applicant "significant financial hardship".

(g) Sixth, pursuant to s 440(5)(*c*), s 440(1) would not apply to contracts which are "likely to affect the national interest or economic interest of Singapore, as may be prescribed". Regulation 5 of the Insolvency, Restructuring and Dissolution (Prescribed Contracts under Section 440) Regulations 2020 in turn provides that "a contract for the supply of goods or services to the Government or a public body that are essential for the Government or the public

11 A receiver may be appointed by a debenture holder pursuant to s 24 of the Conveyancing and Law of Property Act 1886 (2020 Rev Ed), a contractual term contained in the debenture, or by the court.

12 [2021] 2 SLR 478.

13 The cash flow test assesses whether a debtor's current assets exceed its current liabilities such that it is able to meet all debts as and when they fall due. "Current assets" and "current liabilities" refer respectively to assets which would be realisable and debts which would fall due within a 12-month timeframe.

14 The overall balance sheet test assesses whether, on an overall basis, the debtor's assets are sufficient to discharge its liabilities, including contingent and prospective liabilities.

> body to carry out its functions" would fall within such excluded contracts. Hence, depending on the nature of the public projects undertaken, the application of s 440 may be excluded.[15]

III. Application of s 440 in construction contracts

7 This section analyses the application of s 440 of the IRDA in two scenarios which commonly feature in construction contracts in Singapore, namely the termination of a contractor's employment, as well as an employer's calls on a performance bond.

A. Termination of contractor's employment

8 Construction contracts commonly provide that the employer can terminate the contractor's employment in the event of the contractor's insolvency, appointment of a judicial manager, or a compromise agreement being entered into between the contractor and its creditors.

9 These provisions are found in commonly used standard forms including but not limited to the REDAS Design and Build Conditions of Main Contract (4th Ed) ("REDAS") and the Public Sector Standard Conditions of Contract for Construction Works 2020 ("PSSCOC"). Both standard forms provide that the employer may terminate the employment of the contractor if the contractor: [16]

> … has committed an act of bankruptcy or becomes bankrupt or insolvent or makes a composition with creditors or if, being a company, any winding up order of any kind is made, or a receiver or manager or judicial manager of the Contractor's undertaking or assets is appointed, or possession taken or execution levied by creditors or debenture holders under a floating charge.

10 Pausing here, there are slight differences between the wording of the said clause in the REDAS and PSSOC in so

15 Insolvency, Restructuring and Dissolution Act 2018 (2020 Rev Ed) s 440(5)(*c*).
16 See cl 30.2.2.6 of the REDAS Design and Build Conditions of Main Contract (4th Ed) and cl 31.1(2)(a) of the Public Sector Standard Conditions of Contract for Construction Works 2020.

far as the right to terminate in the PSSCOC is subject to the express qualification that such right must not have been "prohibited by written law",[17] thereby giving clear deference to the IRDA. Nonetheless, the lack of equivalent wording in the REDAS is unlikely to make any material difference given s 440(3), which provides that s 440 would trump any contrary contractual provision.

11 As mentioned at para 6(d) above, the employer would *not* be barred by s 440 from terminating the contractor's employment by reason only of the occurrence of any of the following events:

(a) Where winding up proceedings have been commenced against the contractor. In such circumstances, the protection afforded by s 440 of the IRDA is not required since there is arguably little to no prospects of rehabilitation.[18] In this regard, it would also be appropriate for the restriction on enforcement of *ipso facto* clauses to be lifted if the contractor transitions from a prior restructuring regime (such as a scheme of arrangement or judicial management both of which are s 440 Proceedings) to a winding up.[19]

(b) The appointment of receivers or receivers and managers in respect of the contractor's assets.

12 However, the employer would be barred by s 440 from terminating the contractor's employment if the employer relies *solely* on the occurrence of any of the s 440 Proceedings.

13 Following this logic, the employer would arguably be allowed to exercise its right of termination upon the occurrence of events of default going beyond the s 440 Proceedings or the contractor's insolvency, even if this is coupled with the

17 Public Sector Standard Conditions of Contract for Construction Works 2020 cl 31.1(2).

18 Law Reform Committee, Singapore Academy of Law, *Report on the Building and Construction Industry Security of Payment Act and Corporate Insolvency and Restructuring* (April 2020) at para 7.28 (Chairman: Ashok Kumar).

19 Law Reform Committee, Singapore Academy of Law, *Report on the Building and Construction Industry Security of Payment Act and Corporate Insolvency and Restructuring* (April 2020) at para 7.29 (Chairman: Ashok Kumar).

occurrence of any of the s 440 Proceedings. This was made clear by The Senior Minister of State for Law, Edwin Tong, at the Second Reading of the Insolvency, Restructuring and Dissolution Bill, wherein the following extract is of relevance:

> If the main contractor is in financial distress and files an application to Court to place the company into judicial management, the developer will be restricted by clause 440 from relying on the ipso facto clause, because it is triggered by the filing of the application for a judicial management order, which is one of the specified restructuring proceedings in clause 440(6).
>
> *If, however, in addition to the filing of the restructuring proceedings, the main contractor also fails to meet construction milestones and timelines which are built into the contract, the developer may use the ipso facto clause to terminate the contract or for a variety of other reliefs as specified in the contract. So, it is only by reason of the restructuring efforts set out in clause 440 alone that these ipso facto clauses are restricted.*
>
> [emphasis added]

14 Examples of such events of default going beyond the s 440 Proceedings or insolvency include (amongst others) the contractor's failure to comply with the employer's representative's written instruction to proceed with the works expeditiously within a stipulated period[20] or the contractor's stoppage of works on site.[21].

15 In practice, the protection afforded to contractors by s 440 may be limited as a contractor undergoing any of the s 440 Proceedings is one that is already in a state of financial distress. It is thus conceivable that the contractor may be struggling to carry out works in accordance with contractual requirements and there is a real likelihood of delays or stoppage to works on site. In such cases, the contractor remains susceptible to termination since the employer is not prevented from relying on grounds for termination other than the occurrence of s 440 Proceedings or insolvency to terminate the contract. The protection offered to

20 REDAS Design and Build Conditions of Main Contract (4th Ed) cl 30.2.2.1.
21 *Jia Min Building Construction Pte Ltd v Ann Lee Pte Ltd* [2004] 3 SLR(R) 288 at [59].

creditors may therefore be limited unless employers are willing to grant indulgence including, for instance, granting extensions of time for the contractor to meet the various construction milestones and timelines.

B. Call on on-demand performance bond

16 Section 440 is unlikely to prevent an employer's call on an on-demand performance bond regardless of whether the contractor is undergoing any of the s 440 Proceedings or is insolvent at the material time.

17 First, an on-demand performance bond is by definition a contract under which a guarantor (usually a bank or an insurer) undertakes to pay a creditor (*ie*, employer) a sum of money upon the creditor's demand. The guarantor can therefore be held liable to the creditor even without proof of any failure by the principal debtor to perform its obligations to the creditor and even if there has been no such failure.[22] To this end, the reason for the call on the on-demand performance bond is arguably irrelevant.

18 In any event, the contractor is likely to face evidential hurdles in demonstrating that a bond call was made by reason *only* that the contractor is undergoing one of the s 440 Proceedings or that the contractor is insolvent, and for no other reason. This is especially so if the contractor is already in delay and liquidated damages for late completion are accruing to the employer, or that the employer has already been made to incur additional costs such as back charges arising from the contractor's delays.

19 Second, since an on-demand performance bond is not a contract between the employer and contractor, the call on the bond would arguably not be claiming an accelerated payment under an agreement "with the company", as required under s 440(1)(*a*).

22 *TA Private Capital Security Agent Ltd v UD Trading Group Holding Pte Ltd* [2024] SGHC 11.

20 To this, a counterargument can be made that a substance over form approach ought to be preferred in determining whether s 440 applies to restrict such calls. Section 440(3) provides that any provision which has the effect of providing for anything that in substance is contrary to s 440 is of no force or effect. In this regard, while the on-demand performance bond is not strictly speaking a contract between the employer and contractor, it is an arrangement which arises from and in connection with the underlying construction contract between the employer and contractor, and is therefore in substance an arrangement involving the contractor. Further, this wider interpretation would accord with the spirit and intent of s 440, which is to provide support to financially distressed contractors who are undergoing restructuring proceedings. However, this argument may not find favour with the Singapore courts given the following point.

21 Third, even if a bond call amidst a contractor's ongoing restructuring efforts is likely to exacerbate the contractor's financial difficulties, the Singapore courts are unlikely to allow contractors to resist bond calls on such grounds alone.

22 A bond call at the time when contractors are undergoing a s 440 Proceeding could conceivably undermine the purpose of the s 440 Proceedings, which is to allow the contractor in financial distress to undergo restructuring in order to remain as a going concern. The contractor would now incur a crystallised debt *vis-à-vis* the bond issuer, and may also have to commence litigation or arbitration proceedings against the employer to recover any overpayments made to the employer from the performance bond moneys. Such disputes often involve complex and protracted claims and counterclaims regarding the employer's extent of entitlement to the performance bond moneys, which would in turn only further exacerbate the contractor's financial difficulties. It is therefore arguable that a bond call in these circumstances would be contrary to the intent of s 440.

23 However, such arguments are unlikely to satisfy the Singapore courts that the call on the on-demand performance bond ought to be resisted. The Singapore High Court in *Sulzer Pumps Spain, SA v Hyflux Membrane Manufacturing (S)*

Pte Ltd[23] considered the issue of whether a contractor's call on a performance bond despite the subcontractor's ongoing restructuring would be a factor suggesting a strong *prima facie* case of unconscionability. Aedit Abdullah J answered in the negative and observed as follows:[24]

> However, the fact that the first respondent is in the midst of restructuring, or even if hypothetically on the verge of insolvency, would not be reason to grant an injunction if unconscionability is not made out. The rationale for the strict threshold espoused at [31] above bears repeating: a performance bond is a security that has been bargained for, and the court should not disrupt the status quo unless the applicant meets the threshold of proving either unconscionability or fraud. *Parties calling on bonds are not to be treated differently merely because they are in the midst of a restructuring. The fact that the obligor may be exposed to the financial constraints of the beneficiary is not good enough reason to bar the call if no other reason exists. This is part and parcel of the contractual arrangement that they have made between themselves in arranging for the performance bond.* [emphasis added]

24 While the case preceded the enactment of s 440, it appears that an applicant contractor seeking an injunction to restrain a bond call is unlikely to succeed in establishing a strong *prima facie* case of unconscionability if that would in effect depart from their contractual bargain.

IV. Practical tips

25 This section proposes some practical tips which can be considered at the contract drafting or procurement stage, and even after.

26 First, it would be helpful for the employer to expressly provide for the following (amongst others) to be separate and standalone grounds for termination:

23 [2020] 5 SLR 634.
24 *Sulzer Pumps Spain, SA v Hyflux Membrane Manufacturing (S) Pte Ltd* [2020] 5 SLR 634 at [53].

(a) the contractor's failure to meet construction milestones and timelines, and the right to terminate for breach of any of these milestones and timelines;

(b) the contractor's abandonment of works; and

(c) the contractor's failure to comply with the employer's instructions.

27 As mentioned above, s 440 only bars the employer from terminating the contract and/or accelerating payments if such action(s) is taken by reason only of the contractor's insolvency or the fact that the contractor is undergoing a s 440 Proceeding. The employer would not however be barred by s 440 from relying on any of the above listed grounds, regardless of whether the contractor was insolvent or undergoing a s 440 Proceeding at the material time.

28 That said, a balance ought to be struck as an overly onerous provision, which provides that the failure to meet construction milestones regardless of how inconsequential it is would give rise to the employer's right to terminate, may not necessarily benefit the employer as contractors may be incentivised to price in such risks, leading to a higher contract sum.

29 Second, the employer may also apply to the court pursuant to s 440(4) for a declaration that s 440 does not apply in whole or in part. This allows the employer to seek prospective sanction from the court, before proceeding with its intended course of action.

30 As foreshadowed above, the employer will need to satisfy the court that the operation of s 440 would otherwise likely cause the employer "significant financial hardship". The issue of what amounts to "significant financial hardship" has not come before the Singapore courts to date. Given that s 440 of the IRDA is modelled after s 34 of the Canadian Companies' Creditors Arrangement Act,[25] one may seek guidance from Canadian cases

25 RSC 1985, c C-36 (Can). See Law Reform Committee, Singapore Academy of Law, *Report on the Building and Construction Industry Security of Payment*

(cont'd on the next page)

which have considered the issue of what amounts to "significant financial hardship". In this regard, it appears that the Canadian courts will consider the interests of all stakeholders in determining "significant financial hardship".[26] Accordingly, the courts may be more hesitant to make a declaration under s 440(4) in favour of the employer if, for instance, the termination of the contractor's employment is likely to cause a cascading effect on other parties down the line (*eg*, subcontractors and suppliers).[27]

31 It remains to be seen how this exception of "significant financial hardship" will be interpreted before the Singapore courts. One way for the employer to strengthen its case would be to specifically document in the contract (for instance, in the recitals) the facts which would cause "significant financial hardship" to the employer. This could help to pre-empt any potential court application under s 440(4).

32 Third, and notwithstanding the above, it may not always be in the employer's interests to terminate the contractor's employment. While the employer can seek damages and other relief against the contractor post-termination, this would involve risks including (amongst other) the uncertainty of litigation, as well as the possibility of long drawn legal battles. Further, the crippling effect of termination of key contracts could put an end to the contractor's restructuring efforts. In such circumstances, liquidation may be inevitable and the employer (assuming that it is part of the general body of creditors) is likely to enjoy much less recovery than if the contractor had been rehabilitated.

33 Hence, assuming that there remains on a balance some value in retaining the contractor (for instance, if the contractor is a specialist in particular works), the employer can consider a more consultative approach supported by existing contractual

Act and Corporate Insolvency and Restructuring (April 2020) at paras 7.13–7.16 (Chairman: Ashok Kumar).

26 See *Toronto-Dominion Bank v Ty (Canada) Inc* 2003 OJ No 1552 at [22(k)], where the court held that to lift a stay of proceedings, and thus permit the termination of distribution arrangements and trademark licence agreements with the debtor would be to the detriment of all stakeholders of the debtor.

27 Adrienne Ho, "The Treatment of Ipso Facto Clauses in Canada" (2015) 61(1) *McGill Law Journal* 139 at 184 and 185.

tools, such as the provision of advance payments to assist the contractor with cash flow issues or the omission of parts of the contractor's scope of works in order to alleviate the strain on resources faced by the contractor undergoing restructuring.

V. Conclusion

34 The introduction of s 440 signals greater protection and support for distressed contractors undergoing restructuring efforts. Nonetheless, deserving contractors would only be able to avail themselves of the protection intended by this provision if employers are also willing to adopt a collaborative and consultative approach (instead of an uncompromising one) in support of the contractors' restructuring efforts. This is in line with calls for closer collaboration within the construction industry, where all stakeholders are encouraged to "work together to resolve differences, develop solutions and share risks to meet common project goals".[28]

28 Building and Construction Authority, "Closer Collaboration to Accelerate Industry Transformation: A New Roadmap for the Built Environment Sector" (17 September 2022) <https://www1.bca.gov.sg/buildsg-emag/articles/closer-collaboration-to-accelerate-industry-transformation-a-new-roadmap-for-the-built-environment-sector> (accessed 2 August 2024).