

On 25 June 2020 the Corporate Insolvency and Governance Act (the Act) received Royal Assent. The Act makes both temporary and permanent changes to the UK insolvency laws.

As part of these measures, a new provision has been inserted into existing legislation which will curtail the ability of suppliers to terminate supply contracts when a customer becomes insolvent (the so called 'ipso facto regime').

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Restrictions on Termination

Most contracts for the supply of goods and services contain a termination clause (also known as an ipso facto clause) which, on the occurrence of an insolvency-related event, either:

1. Automatically terminates the contract, or
2. Entitles the supplier to terminate the contract.

The changes to existing UK insolvency laws that will prevent a supplier from terminating a supply contract because its customer has entered a 'relevant insolvency procedure'.

In short, unless the supplier falls within the definition of exempt suppliers or exempt contracts, the supplier cannot terminate the supply contract (for insolvency-related reasons) and will have to continue to supply under the terms of the contract, despite the fact that its customer is insolvent.

What is a 'relevant insolvency procedure'?

A 'relevant insolvency procedure' includes administration (from the date of the appointment - not from the date of any notice of intention to appoint), administrative receivership, company voluntary arrangements (CVA), liquidation, provisional liquidation, the new moratorium (see further below) and restructuring plan.

Exemptions

The following specific suppliers and contracts are exempt from the ipso facto regime:

- Suppliers classed as '*essential suppliers*' (which will be dealt with under the existing essential supplier regime).
- Certain persons involved in financial services.
- Contracts involving certain financial services.
- Suppliers classed as '*small suppliers*' – but only for a limited period.

Small Suppliers

For a temporary period (ending on 30 September 2020) small suppliers will be exempt from the changes and can (if they chose) terminate the supply contract.

This is a temporary exemption designed to address the current difficulties faced by UK companies as a consequence of COVID-19 and will capture suppliers who meet at least two of the following three criteria:

- Employ less than 50 people.
- Have a balance sheet with assets totaling £5.1 million or below.
- Have a turnover of £10.2 million or below.

The criteria differs slightly when the supplier has been trading for less than one year.

When the temporary period expires (unless extended) small suppliers will be caught by the new ipso facto regime and will not be able to terminate their supply contract for insolvency-related reasons.

Protection For Suppliers

The Act introduces measures designed to balance any perceived unfairness:

Hardship

A supplier can apply to court seeking an order exempting them from the ipso facto regime and allowing them to terminate. However, in order to do that, the supplier will have to demonstrate that it will suffer hardship, as a consequence of continuing to supply. There is no definition of hardship and a supplier is likely to find that demonstrating hardship will be challenging, as the court will have to balance whether the supplier's hardship outweighs the interests of creditors.

Payment

Claiming hardship for reasons of non-payment is unlikely to be sufficient, given the other protection afforded to suppliers, i.e. that the supplier is entitled to be paid for any goods or services supplied post-insolvency.

Further, in the case of the customer entering a 'new moratorium' (see further below), if the company fails to pay for supplies made during the moratorium period, the supplier will be paid ahead of other creditors in any subsequent insolvency – including charge holders.

Can Suppliers Change Their Terms of Supply?

The Act also prevents suppliers from doing '*any other thing*' upon a company becoming subject to a relevant insolvency procedure. The explanatory notes to the Act indicate that this is aimed at preventing suppliers from changing payment terms, but this will not prevent suppliers reviewing and amending terms and conditions with customers pre-insolvency.

Payment of Pre-Insolvency Debts

- Under the new measures, a supplier is expressly prohibited from making the payment of pre-insolvency debt arrears a condition of continuing supply.
- There is no mechanism to make an office holder personally guarantee the payment of ongoing charges.
- Any pre-insolvency debts are unsecured debts and will only be paid (*pari passu*) following payment of insolvency expenses, and secured charge holders.
- If a customer applies for the new moratorium, the company is expressly prohibited from paying pre-moratorium debts (subject to statutory minimum payments).

When Can A Supplier Terminate?

A supplier is able to terminate a supply if:

- The office holder consents (in an administration, administrative receivership, liquidation and provisional liquidation).
- The company consents (in a CVA, statutory moratorium or a restructuring plan).
- The court is satisfied that the continuation of the contract would cause the supplier hardship and grants permission.

It should, however, be noted that the prohibition limits the ability to terminate a supply contract for reasons of insolvency. A supplier can still terminate the contract on other grounds (such as non-payment or breach of contract), however only where the contractual right to terminate arises post insolvency.

The ipso facto regime impacts supply contracts under which there is a continuing obligation to supply. A supplier can refuse to accept individual orders and cannot be forced to supply a customer that has entered a relevant insolvency procedure, unless they are already under an obligation to supply.



Retention of Title

The ipso facto regime does not necessarily impact a supplier's rights to enforce a retention of title clause (ROT). However, if the company is in an insolvency process, there may be a moratorium in place that prevents the supplier from enforcing ROT.

In administration, a supplier cannot enforce ROT without the consent of the administrator or court. Under the new moratorium, the supplier is prohibited from enforcing ROT (without court consent) but may be required to continue supplying the company under the supply contract. The difficulty here is that typical ROT clauses usually permit a customer to sell stock subject to ROT 'in the ordinary course of business' (and the new moratorium permits a company to continue to trade) but because the moratorium is in place, the supplier cannot enforce its ROT to recover payment for pre-moratorium arrears. To preserve the value of ROT, a supplier may wish to consider amending its terms and conditions to accelerate payment of future supplies if its customer enters a new moratorium, so that it is in a better position to negotiate payment.

Mitigating the Impact

Suppliers should consider:

- Keeping on top of payment terms. Once a customer enters a relevant insolvency procedure, any arrears are unlikely to be repaid in full. As a result, suppliers should ensure that receivables are paid when due, consider reducing payment periods and review and (if necessary) tighten debt collection procedures.
- Reviewing terms and conditions. It is good practice for any business to ensure that their terms and conditions are up to date and fit for purpose.
- Suppliers should pay particular attention to:
 - Their rights and remedies under these arrangements (including any applicable notice and cure periods).
 - Considering whether to terminate the arrangement prior to entry into an insolvency process (e.g. following a NOI).
 - Understanding when title to goods passes and reviewing ROT clauses.
 - Confirm whether the contract contains a continuing obligation to supply.

The New Insolvency Moratorium

In addition to the introduction of the ipso facto regime, the Act introduced a new insolvency moratorium.

This will provide a simple way for companies who cannot or are unlikely to be able to pay their debts, to obtain the benefit of a moratorium for an initial 20 business days, with the option to extend that by a further 20 business days (up to 12 months with creditor/court consent), providing breathing space from creditor pressure and a payment holiday for certain debts. The ipso facto provisions will also apply when a company enters a new moratorium.

Similar to a Chapter 11 restructuring in the US, the company remains in the directors' control during the period of the moratorium, but is 'monitored' by an insolvency practitioner.



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