

This quick guide looks at how the ‘ipso facto regime’ (namely the ability of suppliers to terminate supply contracts when a customer becomes insolvent) works in an insolvency, and also considers how suppliers can mitigate the impact of that regime on their contracts.

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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 ipso facto regime which comes into effect when a company enters a “relevant insolvency procedure” prevent a supplier from exercising termination rights and terminating a supply contract.

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, a moratorium and a 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.

Protection For Suppliers

The following measures are designed to balance any perceived unfairness if the supplier is prevented from terminating its supply contract:

Hardship

A supplier can apply to court seeking an order exempting them from the 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 for Supplies Made

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

Further, in the case of the customer entering a moratorium, 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?

Suppliers are prohibited from doing *'any other thing'* upon a company becoming subject to a relevant insolvency procedure. 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

- 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 supplies.
- Any pre-insolvency debts are unsecured debts and will only be paid (*pari passu*) following payment of insolvency expenses, preferential creditors and secured charge holders.
- If a customer applies for a 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 only 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 in those circumstances be forced to supply a customer that has entered a relevant insolvency procedure.

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 statutory moratorium in place that prevents enforcement.

In administration, a supplier cannot enforce ROT without the consent of the administrator or court. If a company enters a moratorium – the supplier is prohibited from enforcing ROT (without court consent). 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 if the insolvent customer continues to trade (which it might do if administrators are appointed, and can also do if a 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 could consider amending its terms and conditions to accelerate payment of future supplies if its customer enters a 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.



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