



# CORPORATE INSOLVENCY AND GOVERNANCE BILL 2019-20: GENERATIONAL INSOLVENCY REFORM RESTRICTS *IPSO FACTO* PROVISIONS AND PRE-EXISTING TERMINATION RIGHTS

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## INTRODUCTION

On 20 May 2020 the Government introduced the [Corporate Insolvency and Governance Bill 2019-20](#) (the “Bill”) in the House of Commons. The Bill contains far-reaching reforms to the insolvency regime under the Insolvency Act 1986 (the “Act”), which our Restructuring and Insolvency Team has covered in detail [here](#). One area which will have a material impact on commercial contracts is the introduction of restrictions on *ipso facto* provisions, and similar provisions, in supply contracts. The Government intends for the Bill to pass into law on an expedited timetable, going through the remaining stages in the Commons on 3 June before passing to the Lords.

*Ipsa facto* provisions - included in most supply contracts - permit a party to terminate a contract upon the counterparty suffering an insolvency event. While this provides important protection to the solvent party, it has long been recognised that termination (or the threat of termination) of key supply contracts can, in certain circumstances, have a significantly detrimental impact on the prospects of rescuing a viable but financially distressed party. The Government has therefore sought to follow the trend in other jurisdictions in imposing restrictions on the use of such clauses, as well as restricting the ability of a supplier to exercise certain other rights after a company becomes subject to a relevant insolvency procedure.

Whilst the timing of the Bill’s introduction is clearly related to the current COVID-19 situation, the proposed changes are not temporary or restricted in nature by reference to COVID-19 and are consistent with previous indications from the Government, dating back to 2016, that it would legislate against *ipso facto* clauses.

## WHICH CONTRACTS ARE AFFECTED?

The new provisions will affect any contract for the supply of goods or services (regardless of the date the contract was entered into) unless specifically excluded by the Act. This is a significant extension on the existing restrictions on *ipso facto* clauses in the Act related to contracts for the supply of essential goods and services (such as utilities and IT services), which will continue to apply.

The new provisions will not apply to a wide range of financial contracts (e.g., loan agreements, securities contracts, commodities contracts, futures and derivatives), or where one or both contracting parties is in the financial services sector (e.g., deposit-taking banks, investment banks and insurance companies).

In addition, due to the current hardship being faced by many smaller suppliers in light of the COVID-19 pandemic, the new provisions will not apply to “small entity” suppliers where the counterparty enters a relevant insolvency procedure before 30 June 2020 (although this date may be extended by the Secretary of State). A “small entity” supplier is (broadly speaking) a supplier that meets at least two of the following criteria: a turnover of less than £10.2 million; a balance sheet total of less than £5.1 million; and/or employs 50 people or less.

## WHAT ARE THE RELEVANT INSOLVENCY PROCEDURES?

The new provisions apply when a company has become subject to a “relevant insolvency procedure”, being:

- a) a moratorium comes into force for the company under the new moratorium procedure;
- b) the company enters administration;

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- c) an administrative receiver of the company is appointed;
- d) a company voluntary arrangement takes effect in relation to the company;
- e) the company goes into liquidation or a provisional liquidator is appointed; or
- f) a convening order is made by the court in respect of a restructuring plan.

This does not include schemes of arrangement. These, of course, will not necessarily align to the definition of ‘Insolvency Event’ (or equivalent) in a contract, which may include “softer” insolvency triggers. Note that the new provisions will only be triggered in respect of the relevant insolvency procedures under the Act; they will not apply where a company is subject only to equivalent procedures in other jurisdictions.

Suppliers may, therefore, wish to consider including alternative triggers in the event of company financial distress which pre-empt a potential insolvency. For example, such triggers could be tied to a breach of a financial covenant test which indicates financial distress (e.g., a drop in credit rating or net asset value below a defined threshold). We discussed the inclusion of such tests in our [previous publication](#), which looked at practical tips to mitigate the risk of supplier insolvency.

### WHICH CLAUSES ARE AFFECTED?

#### *Ipsa facto clauses*

A provision which provides for the contract or the supply to terminate or any other thing to take place (or for the supplier to be entitled to terminate or to do any other thing) because the company becomes subject to a relevant insolvency procedure, will cease to have effect upon the company entering into the relevant insolvency procedure. It does not appear that such clauses triggered by an associated company being subject to a relevant insolvency procedure are caught by the new restrictions.

The scope of the words “any other thing” is extremely broad and may give rise to some questions of interpretation. It appears to extend far beyond preventing termination / suspension by the supplier. For example, it could catch clauses

that, upon a relevant insolvency procedure: provide for different payment terms (e.g., default interest or shorter payment periods); require the company to post credit support; entitle the supplier to require additional information from the company; and/or provide for exclusivity restrictions to fall away. In addition, this might cover a right to call on a guarantee given in a supply contract (rather than in a stand-alone guarantee) which would otherwise be triggered by the company becoming subject to a relevant insolvency procedure.

#### *Termination rights arising prior to insolvency*

A supplier is also prohibited from exercising, during an insolvency period, a right to terminate the contract (or the supply under that contract) which arose prior to the insolvency period. This applies regardless of the nature of the event or circumstance giving rise to the termination right and one can foresee extreme scenarios arising; for example, a supplier being prevented from terminating notwithstanding the fraud, wilful misconduct or anti-bribery / corruption breach of the company that occurred pre-insolvency.

In addition, a supplier is prohibited from making it a condition of any supply of goods and services after the time when the company becomes subject to a relevant insolvency procedure, that any pre-insolvency outstanding charges are paid.

Therefore, a supplier will need to take into account the “use it or lose it” risk when considering whether to exercise termination rights (e.g., for non-payment or material breach) in a scenario where there are concerns surrounding a counterparty’s financial position.

### PROTECTION FOR SUPPLIERS

#### *Agreement with office holder / company and “hardship” court orders*

The supplier can agree with the relevant office holder, or the company itself, to terminate the contract despite the operation of the new provisions. The supplier also has the option to apply to court to have the contract terminated, but it will have to show that continued performance would cause it “hardship”. Unfortunately, “hardship” is not defined. In the Government’s 2018 [consultation response](#), it was

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suggested that the court, when determining “hardship”, should consider whether a supplier would be more likely than not to enter an insolvency procedure as a consequence of continued performance. However, this has not been included in the Bill and it remains to be seen how the court will interpret what constitutes “hardship”.

### *Payment for continued supplies*

In order to give some comfort to suppliers that are obliged to continue to provide services to companies that enter the new moratorium procedure, the Bill provides that, if the company goes into liquidation or administration within 12 weeks of the moratorium ending, debts in respect of goods or services supplied during the moratorium will be paid in priority to many other types of claim.

This protection does not extend to debts owed to the suppliers before the company entered the moratorium. However, although the supplier cannot make payment of pre-moratorium charges a condition of continued supply, the company itself may choose, in certain circumstances, to pay such liabilities.

### *Termination rights arising during the insolvency period*

The supplier is not prohibited from exercising rights to terminate (other than *ipso facto*

termination rights) that arise *after* the company enters the relevant insolvency procedure (e.g., for non-payment by the company of an amount falling due, or for material breach occurring, during the insolvency period).

## CONCLUSION

The changes proposed by the Bill are the most substantial reforms to UK insolvency law in a generation, and the changes summarised above could have far-reaching and potentially unintended effects.

It remains to be seen whether suppliers will adopt negotiating positions in their contracts to mitigate against the new risks imposed on them. For example, suppliers may seek to include rights (whether termination or otherwise) triggered by tests which indicate a deterioration in financial covenants, rather than by formal insolvency proceedings, and hence enable the supplier to exercise rights in the run-up to insolvency. The new measures will offer no protection to companies in these circumstances.

In addition, when a termination right does arise, suppliers will need to consider even more carefully whether to exercise that right, given the risk of temporarily losing it if its counterparty subsequently becomes subject to a relevant insolvency procedure.

**If you would like further information about the impact of COVID-19 on your business, please speak to your usual Slaughter and May contact.**



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