UK Corporate Insolvency And Governance Act: Termination Clauses In Supply Contracts

28 September 2020
By: Christopher Roberts | Jared Green

The Corporate Insolvency and Governance Act 2020 introduces a range of changes to UK insolvency law of a magnitude not seen since the reforms of the Enterprise Act 2002. One of the reforms included in the Act is a wide ranging prohibition on the operation of termination clauses in contracts for the supply of goods and/or services where the counterparty enters a relevant insolvency process.

What do the provisions do?

Under the new provisions, suppliers will be prevented from:

- terminating a contract or supply or doing "any other thing", because the company has entered a relevant insolvency procedure;
- terminating a contract or supply for breaches which occurred prior to the relevant insolvency procedure; or
- making it a condition of future supplies that pre-insolvency arrears are paid.

They will, however, still be allowed to terminate the contract:

- for new breaches which happen after the insolvency procedure begins;
- with the permission of the insolvency office holder or directors (depending on which insolvency procedure the company is in); or
- with the permission of the court provided the court is satisfied that continuation of the contract would cause the supplier hardship.

What “hardship” means is not defined within the Act and may represent an area of future dispute to be resolved by the courts.

The new provisions will apply where a company becomes subject to a "relevant insolvency procedure", which is defined as a moratorium under Part A1; administration; administrative receivership; CVA; liquidation; provisional liquidation; or restructuring plan. The moratorium and restructuring plan are new procedures also introduced by the Act.

While the restructuring plan process is included in the list of "relevant insolvency procedures" a scheme of arrangement is not, which is logical as a scheme is not an insolvency process. Companies wishing to avail themselves of these provisions, in order to maintain supply contracts, could therefore consider using the restructuring plan process in place of a scheme (if eligible) or would need to use the new moratorium or another relevant insolvency procedure in parallel.
What is "any other thing"?

The wording "any other thing" is not specifically defined and is a particularly broad concept. The government explanatory notes provide just one example – that changing payment terms will be prohibited. However, the wording is much broader than that and captures the exercise of any contractual right triggered upon an event of insolvency.

When will the new provisions apply?

The new provisions (set out in a new s233B of the Insolvency Act 1986) apply where the relevant insolvency procedure commenced on or after 26 June 2020 (the day the Act came into force). They will apply in respect of contracts entered into before as well as after that date.

This is a different approach to that taken when similar provisions in relation to termination of a narrower category of "essential supplies", where the company enters administration or CVA, were introduced in 2015. Those provisions (in section 233A of the Insolvency Act) only apply where the contract was entered into on or after 1 October 2015.

What about the existing essential supplies restrictions?

The Insolvency Act already includes provisions prohibiting the termination of contracts and supplies in relation to certain "essential supplies". Broadly these cover utility suppliers and suppliers of certain categories of things enabling anything to be done by electronic means (for example suppliers of computer software). Those provisions, section 233A, as mentioned above, and section 233 of the Insolvency Act, operate slightly differently and, notably include requirements for insolvency office holders to provide personal guarantees to secure ongoing supply, which the provisions introduced by the Act do not.

The existing "essential supplies" provisions will continue to apply. Where contractual termination provisions cease to have effect under the existing section 233A the new provisions will not apply. This has the potential to give rise to some anomalies. For example, given the approach to when the provisions begin to apply it is possible that there could be an essential supplier with supply contracts entered into both pre and post 1 October 2015. If the customer goes into administration the post-October 2015 contract would be dealt with under the existing "essential supplies" provisions and the pre-October 2015 contract would fall to be dealt with under the new s233B provisions.

What Are The Exclusions?

Within a new schedule 4ZZA of the Insolvency Act there is a long list of excluded companies and particular types of contract, which include certain financial institutions and various financial and capital-markets contracts.

Critically, these exclusions capture lending contracts so there is no obligation to continue to supply finance to companies in a relevant insolvency procedure. Additionally, the provisions will not apply to specified small suppliers until 30 March 2021. The small supplier definition is based on various turnover, balance sheet and employee headcount tests.

Conclusion

These new provisions represent a further modernisation of corporate restructuring law and ought to be welcomed as an attempt to enhance the rescue opportunities for financially distressed companies. The intention of preventing a supplier from holding a distressed or insolvent company to ransom by threatening to disrupt its supply chain could be considered as a principled one, particularly against the backdrop of the coronavirus pandemic. The opposing view is that it represents an affront to the freedom of contract. Striking the right balance is clearly not easy and this is perhaps reflected by the number of exclusions and carve outs from the provisions.

It remains to be seen whether these new provisions go far enough, how they will work in practice, and how some of the less precise terms such as "any other thing" or supplier "hardship" will ultimately be interpreted by the courts.

The courts’ resources and resolve have been tested by the coronavirus pandemic, and the introduction of new legislation (in short order) and the application of these new provisions as they bed in will certainly add further pressure. The court timetable and the attendant costs in bringing a claim may dissuade suppliers’ from applying to
court for permission for their contracts to be terminated under the hardship exemption leaving them to reach consensual arrangements with the company or officeholders.

1 The exclusion for small suppliers was initially to be in place until 30 September 2020, but has been extended by The Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of the Relevant Period) Regulations 2020.

AUTHORS

Christopher Roberts
Partner
Manchester | T: +44 (0)20 7349 0296
chris.roberts@dlapiper.com

Jared Green
Legal Director
London | T: +44 (0)20 7349 0296
jared.green@dlapiper.com