

BRIEFING NOTE

CORPORATE INSOLVENCY AND GOVERNANCE ACT 2020

**HOW DO THE NEW PROTECTION OF SUPPLIES OF GOODS
& SERVICES PROVISIONS WORK?**

2 JULY 2020

On 26 June 2020, the Corporate Insolvency and Governance Act¹ (the **Act**) came into force.

The objective of the Act is to provide the flexibility and breathing space that businesses need to continue trading, particularly during the current period of economic uncertainty.

The Act has significant implications for supply contracts as it will prevent many suppliers ending existing contracts once a business is insolvent. The Act will make a big impact on existing supply contracts, and will also affect the drafting and negotiation of new contracts.

In this briefing note, we look at the measures in the Act dealing with the new provisions to protect supplies of goods and services and provide more information on how they work, including:

- when the provisions apply;
- what types of contracts they apply to;
- what happens to contracts to which the provisions apply;
- what relief is available to suppliers; and
- temporary exclusions.

If you have any queries or questions in relation to this briefing note, or any other queries on how the Act might affect your business, please do get in touch with us. We are here to help you.

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¹ <https://www.legislation.gov.uk/ukpga/2020/12/contents/enacted>

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HOW DO THE NEW PROTECTION OF SUPPLIES OF GOODS AND SERVICES PROVISIONS WORK?

1. BACKGROUND	
<p>Why are these new provisions being introduced?</p>	<p>The new provisions are being introduced to help the continuation of supply of goods and services to companies in an insolvency process.</p> <p>The provisions affect certain terms of supply contracts. In particular, the right for the supplier to terminate is heavily impacted.</p>
<p>Is the new regime linked to any other insolvency procedure?</p>	<p>The regime is linked to a number of insolvency processes, which are looked at below.</p>
2. DO THE PROVISIONS APPLY?	
<p>What financial condition does a company need to be in for the provisions to apply?</p>	<p>A company to whom a supplier supplies has to become subject to a 'relevant insolvency procedure' for the provisions to apply. This means any of the following:</p> <ul style="list-style-type: none"> • a new style moratorium under the Act comes into force for the company; • the company enters administration; • an administrative receiver of the company is appointed (except for a successor to another administrative receiver); • a voluntary arrangement approved under Part 1 Insolvency Act 1986 takes effect in relation to the company; • the company goes into liquidation; • a provisional liquidator of the company is appointed (except for a successor to another provisional liquidator); or • a court order is made summoning a meeting relating to compromise or arrangement for the company².
<p>When does a company need to have become subject to a relevant insolvency procedure in order for the provisions to apply?</p>	<p>A company must become subject to a relevant insolvency procedure on or after 26 June 2020.</p>

² Under section 901C(1) of the Companies Act 2006 (as introduced by [Schedule 9](#), Part 1 of the Act).

3. TO WHAT TYPES OF CONTRACTS DO THE PROVISIONS APPLY?

<p>What contracts do the provisions apply to?</p>	<p>The provisions apply to contracts for the supply of goods and services, by a supplier to a company which is subject to any of the relevant insolvency procedures above.</p> <ul style="list-style-type: none"> • The provisions apply to supply contracts irrespective of their date. • Certain contracts are excluded as detailed below. • It does not apply to the contracts between an insolvent supplier and a solvent customer. A customer is entitled (assuming the contract so provides) to terminate if a supplier is insolvent.
<p>Which types of supply contracts and situations do the provisions not apply to?</p>	<p>Many finance contracts are excluded. We also anticipate that there could be potential room for debate regarding the difference between a contract to supply goods (which are not excluded) and a spot contract to supply commodities. In more detail:</p> <ul style="list-style-type: none"> – Contracts where the company or supplier carries on the regulated activity³ of effecting or carrying out contracts of insurance and neither that company or supplier is an exempt person⁴; – Banking Contracts where the company or supplier: <ul style="list-style-type: none"> ○ has permission to carry on the regulated activity⁵ of accepting deposits⁶; ○ is a banking group company⁷; or ○ has a liability in respect of a deposit which it accepted in accordance with certain banking legislation⁸; – Where the company or the supplier is an electronic money institution⁹;

³ Regulated activity has the meaning given to it by [section 22 Financial Services and Markets Act 2000](#) taken with [Schedule 2](#) of that Act and any order under that section.

⁴ An exempt person in relation to a regulated activity has the meaning provided in section [417 Financial Services and Markets Act 2000](#).

⁵ Regulated activity has the meaning given to it by [section 22 Financial Services and Markets Act 2000](#) taken with [Schedule 2](#) of that Act and any order under that section.

⁶ Under [Part 4A of the Financial Services and Markets Act 2000](#).

⁷ Within the meaning of Part 1 of the Banking Act 2009 (see [section 81D](#)).

⁸ Such banking legislation being the [Banking Act 1979](#) or the [Banking Act 1987](#).

⁹ Within the meaning of the Electronic Money Regulations 2011 (S.I. 2011/99) (see [regulation 2](#)).

	<ul style="list-style-type: none">- Where the company or the supplier is an investment firm¹⁰ or an investment bank¹¹;- Where the company or the supplier is an authorised payment institution, a small payment institution or a registered account information service provider¹²;- Where the company or the supplier is the operator of a payment system or an infrastructure provider¹³, or an infrastructure company¹⁴;- Where the company or the supplier is a recognised investment exchange, a recognised clearing house or a recognised CSD¹⁵;- Where the company or the supplier is a securitisation company¹⁶; and- Where the company or the supplier does or has done anything outside of the UK, which if done within the UK, would cause any of the above exclusions to apply. <p>There are also a wide range of exclusions for financial contracts¹⁷, securities financing transactions, derivatives, spot contracts, capital market arrangements and contracts forming part of a public-private partnership.¹⁸</p> <p>The Act also says that the provisions do not affect certain other legislation¹⁹.</p>
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¹⁰ Investment firm has the meaning as provided by the Banking Act 2009 (see [section 258A](#)), disregarding any order made under [section 258A\(2\)\(b\)](#).

¹¹ Investment bank means a company or other entity that has permission under [Part 4A of the Financial Services and Markets Act 2000](#) to carry on the regulated activity (see meaning in footnote 2 above) of (a) safeguarding and administering investments, (b) managing an AIF or a UCITS, (c) acting as trustee or depositary of an AIF or a UCITS, (d) dealing in investments as principal, or (e) dealing in investments as agent.

¹² Within the meaning of the Payment Services Regulations 2017 (S.I. 2017/752) (see [regulation 2](#)).

¹³ Within the meaning of Part 5 of the Financial Services (Banking Reform) Act 2013 (see [section 42](#)).

¹⁴ Within the meaning of Part 6 of the Financial Services (Banking Reform) Act 2013 (see [section 112](#)).

¹⁵ Within the meaning of the Financial Services and Markets Act 2000 (see [section 285](#)).

¹⁶ Within the meaning of the Taxation of Securitisation Companies Regulations 2006 (S.I.2006/3296) (see [regulation 4](#)).

¹⁷ Financial contracts include contracts for the provision of financial services including lending, factoring, financing commercial transactions, financial leasing, providing guarantees or commitments, securities contracts, commodities contracts, futures or forwards contracts and swap agreements.

¹⁸ See Part 3 of Schedule 4ZZA (contained in [Schedule 12, Part 1](#) of the Act) for full definitions and details of these excluded contracts.

¹⁹ This includes Part 7 of the Companies Act 1989 (financial markets and insolvency), the Financial Markets and Insolvency Regulations 1996 (S.I. 1996/1469), the Financial Markets and Insolvency (Settlement Finality) Regulations 1999 (S.I. 1999/2979), the Financial Collateral Arrangements (No.2) Regulations 2003 (S.I. 2003/3226), the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 (S.I. 2015/912) and aspects of the Building Societies Act 1986 and the Friendly Societies Act 1992.

4. WHAT HAPPENS TO CONTRACTS WHEN PROVISIONS APPLY?

<p>What is the impact of the provisions on the terms of an in-scope contract?</p>	<p>Where a company has become subject to a relevant insolvency procedure and the contract is in scope (i.e. because an exclusion does not apply), any provision in the contract that says:</p> <ul style="list-style-type: none"> • the contract or the supply would terminate or anything else would take place, because the company becomes subject to the relevant insolvency procedure; or • the supplier would be entitled to terminate the contract or supply of goods or services or do anything else, because the company becomes subject to the relevant insolvency procedure; <p>will cease to have effect.</p> <p>This does not apply to contracts for the supply of essential goods and services (e.g. gas, water and electricity)²⁰ where the company being supplied enters administration or has a voluntary arrangement approved²¹ and the provision of the contract ceases to have effect under the existing relevant Insolvency Act 1986 provisions relating to essential supplies.²²</p> <p>A contract which also includes within it a guarantee or other arrangement with a party who is neither customer or supplier (e.g. a parent company) will need careful consideration.</p>
<p>What is the position if under the contract, the supplier is entitled to terminate because of an event that occurred before the company became subject to a relevant insolvency procedure?</p>	<p>For example, if the now insolvent customer had materially breached the contract before insolvency happened can the supplier terminate? In short, the answer is "no":</p> <p>In these circumstances, that entitlement to terminate cannot be exercised before the end of the 'insolvency period' for that relevant insolvency procedure.</p> <p>The insolvency period for each relevant insolvency procedure ends:</p> <ul style="list-style-type: none"> • for a new style moratorium under the Act, when the moratorium comes to an end; • for a company entering administration, when the appointment of the administrator ceases to have effect²³; • for the appointment of an administrative receiver of the company, when the receiver or any successor to the receiver ceases to hold office without a successor being appointed;

²⁰ Those mentioned in [section 233\(3\) of the Insolvency Act 1986](#) (e.g. gas, electric and water supplies).

²¹ A voluntary arrangement under [Part I Insolvency Act 1986](#).

²² Under [section 233A\(1\) Insolvency Act 1986](#).

²³ Under paragraphs 76 to 84 of [Schedule B1](#), Insolvency Act 1986 or an order under section 901F of the Companies Act 2006 (as introduced by [Schedule 9](#), Part 1 of the Act).

	<ul style="list-style-type: none"> • for a voluntary arrangement²⁴, when the arrangement ceases to have effect; • for a company going into liquidation, when the liquidator complies with duties relating to final account²⁵ or its appointment ceases to have effect under a court order for a compromise or arrangement²⁶; • for the appointment of a provisional liquidator for the company, when the provisional liquidator or any successor to the provisional liquidator ceases to hold office without a successor being appointed; and • where a court order is made summoning a meeting relating to compromise or arrangement for the company²⁷, when a court order for a compromise or arrangement²⁸ takes effect, or the court decides not to make such an order. <p>This does not apply to contracts for the supply of essential goods and services²⁹ where the company being supplied enters administration or a has a voluntary arrangement approved³⁰ and the provision of the contract ceases to have effect under the existing relevant Insolvency Act 1986 provisions relating to essential supplies.³¹</p>
<p>Can a supplier impose conditions on future supplies, so that outstanding amounts must be paid first?</p>	<p>No. Once a company becomes subject to a relevant insolvency procedure³²:</p> <ul style="list-style-type: none"> • a supplier cannot make it a condition of supply, that outstanding charges for a supply made before that time are paid; and • a supplier cannot do anything else, which has that effect. <p>However, these provisions do not apply to the supply of essential goods and services³³ if the company being supplied becomes subject to a relevant insolvency procedure (other than a new style moratorium under the Act, or a court order being made summoning a meeting relating to compromise or arrangement for the company³⁴) as other protections apply in those cases.</p>
<p>Will the supplier get paid for post insolvency supplies?</p>	<p>In short – probably yes.</p> <p>The payments due for supply during the moratorium must be paid by the company and, if not, the monitor can terminate the moratorium. In the event payments are not made and</p>

²⁴ As approved under [Part 1 Insolvency Act 1986](#).

²⁵ Duties under sections [94\(2\)](#), [106\(2\)](#) or [146\(3\)](#) Insolvency Act 1986.

²⁶ A court order under section 901F of the Companies Act 2006 (as introduced by [Schedule 9](#), Part 1 of the Act).

²⁷ Under section 901C(1) of the Companies Act 2006 (as introduced by [Schedule 9](#), Part 1 of the Act).

²⁸ A court order under section 901F of the Companies Act 2006 (as introduced by [Schedule 9](#), Part 1 of the Act).

²⁹ Those mentioned in [section 233\(3\) of the Insolvency Act 1986](#) (e.g. gas, electric and water supplies).

³⁰ A voluntary arrangement under [Part I Insolvency Act 1986](#).

³¹ Under [section 233A\(1\) Insolvency Act 1986](#).

³² See section 2 (*When do the provisions apply?*) of this briefing note.

³³ Those mentioned in [section 233\(3\) of the Insolvency Act 1986](#) (e.g. gas, electric and water supplies).

³⁴ Under section 901C(1) of the Companies Act 2006 (as introduced by [Schedule 9](#), Part 1 of the Act).

	<p>the company enters either administration or liquidation within 12 weeks of the end of the moratorium, the relevant debts are treated with super priority in that insolvency process.</p> <p>Subject to the above, payments for post insolvency supplies will ultimately be paid in accordance with the rules governing the relevant insolvency procedure (e.g. administration). Suppliers should consider taking any necessary advice on a case by case basis.</p>
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5. WHAT RELIEF IS AVAILABLE TO SUPPLIERS FROM THE PROVISIONS?

<p>If a termination provision ceases to have effect or an entitlement to terminate is not exercisable, in what circumstances can a supplier terminate a contract?</p>	<p>There are three main grounds in which a supplier can terminate:</p> <ul style="list-style-type: none"> • Ground one: Where the relevant insolvency office holder consents to that termination, where: <ul style="list-style-type: none"> – the company enters administration; – an administrative receiver (other than a successor) of the company is appointed; – the company goes into liquidation; or – a provisional liquidator (other than a successor) of the company is appointed; • Ground two: where the company consents to the termination; or • Ground three: with the court's permission, where the court is satisfied that the continuation of the contract would cause the supplier hardship. <p>It is not clear how a court would construe 'supplier hardship'. The Act does not explain what "supplier hardship" is. This will need to be explored in the courts.</p>
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<p>What happens if a provision in a supply contract ceases to have effect, but the company becomes subject to another relevant insolvency procedure? Can a supplier terminate then?</p>	<p>For example if a company goes into the new style moratorium, and then goes into administration can the supplier terminate at the end of the moratorium?</p> <p>If a further 'relevant insolvency procedure' occurs³⁵ and the provisions of a contract cease to have effect³⁶, the supplier can only terminate based on either Ground one (consent of the insolvency office holder) or Ground three (with the court's permission where there is "supplier hardship") above.</p>
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³⁵ See section 2 (*When do the provisions apply?*) of this briefing note.

³⁶ See - What is the impact of the provisions on the terms of an in-scope contract? at section 4- *What happens to contracts that the provisions apply to*)

6. TEMPORARY EXCLUSIONS

What are the temporary exclusions?

Until 30 September 2020, a supplier which is a 'small entity' at the time the company it supplies becomes subject to a relevant insolvency procedure, will not be affected by these provisions.

A supplier will be a 'small entity' if in its most recent financial year at least two of the following apply:

- it had a maximum turnover of £10.2 million³⁷;
- its balance sheet did not exceed £5.1 million³⁸;
- it had no more than 50 employees.³⁹

7. ARE THERE ANY CONSEQUENTIAL AMENDMENTS?

Do these provisions make any changes to other legislation?

Consequential changes are made to the following legislation:

- Insolvent Partnerships Order 1994;
- Limited Liability Partnerships Regulations 2001;
- Co-operative and Community Benefit Societies and Credit Unions (Arrangements, Reconstructions and Administration) Order 2014;
- Limited Liability Partnerships (Scotland) Regulations 2001.

8. Comment

General Comment

Before this change in law, typically a supplier would refuse to continue supply and fulfil a contract until a deal was done regarding the payments due on goods/services delivered pre-insolvency. This option is no longer available. It means suppliers will be in a weaker position. This increases the risk for suppliers.

This is a substantial change in contract law – all well drafted English law contracts have an extensive clause allowing for termination on insolvency which is now ineffective in a supply contract.

³⁷ If the most recent financial year is not 12 months, the figure must be adjusted proportionately. For companies in their first financial year, the supplier's average turnover for each complete month must not have exceeded £850,000.

³⁸ The balance sheet means the aggregate amount of amounts shown as assets in the supplier's balance sheet. The same maximum figure applies to companies in their first financial year.

³⁹ This is an average figure based on employees per month, irrespective of whether they were employed for a complete month or months. This applies equally to companies in their first financial year.

	<p>Note that in many jurisdictions outside the UK suppliers are prevented from terminating on insolvency and therefore this change brings English law into line with many other jurisdictions.</p> <p>Bear in mind this impacts the supply contracts. A customer is able to terminate for insolvency where the supplier becomes insolvent.</p>
<p>Existing Contracts</p>	<p>Many contracts allow termination pre-insolvency – for example a failure to pay, or a termination triggered by the customers taking steps towards insolvency. Therefore, suppliers could manage their risk by monitoring customers very closely and then acting very quickly to terminate before the customer becomes insolvent. This will encourage suppliers not to give the customer the benefit of the doubt.</p> <p>The new law only applies to contracts in existence on insolvency. Therefore, if there is a framework agreement with no obligation on the supplier to accept orders then typically the supplier is still entitled to reject post-insolvency orders which might help manage risk.</p>
<p>New Contracts</p>	<p>In formal standard documents it is typical for the boilerplate to include lengthy termination on insolvency provisions. Our expectation is that it's likely that clauses will continue to be included as they do no harm, and could assist a supplier should they seek to terminate.</p> <p>Even in short form agreements where there is high priority given to reducing word count then insolvency terms will still need to be included for the benefit of the customer (to protect against the supplier's insolvency).</p> <p>Suppliers should review standard termination on insolvency provisions to take account of the new moratorium, and to ensure the provisions catch typical pre-insolvency steps and events.</p> <p>Suppliers should consider including provisions to allow for monitoring for signs of financial distress.</p> <p>Suppliers should consider keeping contracts to as short a term as possible to minimise the exposure to the customer. That, however, needs to be balanced with the commercial appetite to secure the customer as long as possible</p> <p>Where the supplier is obtaining a guarantee by or other relationship with a party who is neither customer or supplier will need careful consideration.</p>

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