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Article Title	Update on the significant changes to insolvency law
Date	

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### Background

1. Commonly, contracts for the supply of goods or services contain a clause which permits a party to terminate an agreement solely on the basis of an insolvency event affecting the other party. This is known as the *ipso facto* clause.
2. The *Ipsa Facto* framework under sections [233](#) and [233A](#) Insolvency Act (“IA”) 1986 prohibits reliance on this clause as it seeks to preserve the UK’s utilities (gas, electricity, water, and IT services). Contracts for supply of these essential services cannot, therefore, be terminated when a company enters an insolvency event.

### Corporate Insolvency and Governance Act (“CIGA”) 2020

3. The [CIGA](#) extends the protections of essential services by virtue of section [233B IA 1986](#). This section prohibits suppliers of long-term supply contracts of such services from terminating its supply contract if its counterparty goes into a relevant insolvency procedure (see Schedule 1).
4. There is particular wording in section [233B \(3\) IA 1986](#) which prohibits termination but also prevents suppliers from doing “**any other thing**” as a consequence of its counterparty entering into a relevant insolvency procedure. This allows for distressed companies to focus on immediate issues rather than be suffocated under the demands of their suppliers.
5. Additionally, the CIGA implements new **temporary** measures as well new **permanent** changes to UK insolvency law, the **permanent measures** include:
  - a. The **moratorium process** now allows for distressed companies to benefit from a payment holiday of its pre-moratorium debts and are protected from some enforcement actions. It also allows a debtor company’s management to retain control of the company and appoint a licenced insolvency practitioner to assist. The initial period for the moratorium will be **20 business days**, however this can be extended or terminated earlier. The moratorium can be extended to **40 business days**, if agreed by the courts or the creditor. The following applies during the moratorium period:
    - i. The directors continue to run the business day to day but under the supervision of an insolvency practitioner, whose consent is required before the directors can undertake certain transactions;

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- ii. Creditors and lenders are unable to take enforcement action against the debtor company;
  - iii. Landlords are unable to exercise rights of forfeiture; and
  - iv. The debtor company must continue to pay certain debts, such as amounts due for new supplies made during the moratorium, rent for the period during the moratorium, wages/salaries, amounts due under financial contracts, which include loan agreements.
- b. The restructure plan now allows Courts to sanction plans that binds dissenting classes of creditors and members (as opposed to minorities within those classes) in what is referred to as a '**cross-class cram-down**'. The purpose of this is to allow a company to compromise its financial and equity structure without succumbing to a pre-pack administration sale of assets.
  - c. Restrictions on termination of contracts for the supply of goods and services.
6. **Temporary measures** in response to the COVID-19 pandemic are the following:
- a. Restrictions on using winding-up processes (now in place until 31 March 2021). A creditor is unable to present a winding up petition, unless there are reasonable grounds to believe that COVID-19 has not had a financial effect on the debtor company, or that the debtor company was unable to pay its debts regardless of COVID-19's financial effect;
  - b. Temporary changes to wrongful trading rules. The Corporate Insolvency and Governance Act 2020 (Coronavirus) (Suspension of Liability for Wrongful Trading and Extension of the Relevant Period) Regulations have suspended wrongful trading liabilities for the period between 26 November 2020 and 30 April 2021; and
  - c. Relaxation of meetings and filing requirements to provide companies with greater flexibility.

#### Case Study: Drafting insolvency procedures into termination clauses

7. By way of case study, an SMB client (a supplier of an essential service) reviewed the below clause and asked us how this could be amended in light of the effect and operation of the CIGA. The clause reads:
- "13.3 **Either party may terminate** this Agreement immediately (or with effect from any later date that it may nominate) by written notice to the other party if **one or more Insolvency Events** occurs in relation to that other party. For the purposes of this clause, 'Insolvency Event' means, in respect of a party (other than for the purpose of solvent reconstruction or amalgamation):*
- a) *a receiver, manager or liquidator is appointed over the party's undertaking or assets or the party enters into any assignment, composition, or arrangement with its creditors; or*

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- b) *the party is **unable to pay its debts** when due or is deemed unable to pay its debts under any law or suspends payment to its creditors.*
8. In its current form, this clause falls foul of the IA 1986 and CIGA as the client has a contractual right to terminate the agreement where the counterparty enters into relevant insolvency procedure and would render it unenforceable. However, the following amendments to this clause would likely circumvent any such claim.

***“Pursuant to section 233B of the Insolvency Act 1986, the Supplier shall not be entitled to terminate this Agreement in the event that the Client enters into one or more Insolvency Events. For the purposes of this clause, ‘Insolvency Event’ means, in respect of a party (other than for the purpose of solvent reconstruction or amalgamation):***

- a) *the Client enters into a moratorium process as defined in Part A1 of the Corporate Insolvency and Governance Act 2020*
- b) *the Client enters administration*
- c) *an administrative receiver of the Client is appointed*
- d) *a company voluntary arrangement takes effect in relation to the Client*
- e) *the Client goes into liquidation or a provisional liquidator is appointed; and*
- f) *in relation to a restructuring plan of the Client, an order is made by the court summoning meetings relating to that restructuring plan.”*

#### SCHEDULE 1: RELEVANT INSOLVENCY PROCEDURES

- a moratorium comes into force for the company;
- the company enters administration;
- an administrative receiver of the company is appointed;
- a company voluntary arrangement takes effect in relation to the company;
- the company goes into liquidation or a provisional liquidator is appointed; and
- in relation to a restructuring plan, an order is made by the court summoning meetings relating to that restructuring plan.

SMB remains fully operational and is here to deal with any commercial queries that you may have during this exceptional time.

Please do not hesitate to get in touch with Partner [Simon Halberstam](mailto:simon.halberstam@smab.co.uk) at [simon.halberstam@smab.co.uk](mailto:simon.halberstam@smab.co.uk) if you want SMB to review and/or update current arrangements to reflect the change in the law.

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