

Solving the insolvent

As the country continues to combat coronavirus, the government has fast-tracked a bill through parliament to provide support to businesses that may become insolvent in the fallout of the pandemic. One of the measures that has been introduced restricts suppliers from terminating contracts with insolvent customers. Simon Key, partner and solicitor in Nelsons' debt recovery team, discusses the *Corporate Insolvency and Governance Act* and what it means for suppliers

We are already starting to see a large number of redundancies in the wake of this year's pandemic – and there are certain changes being brought in to try to enable viable businesses to trade.

One of these is the *Corporate Insolvency and Governance Act*, which aims to help businesses avoid insolvency by offering them greater flexibility and breathing space to survive Covid-19. It is hoped the measures will provide support to businesses that may be experiencing cash flow difficulties in the midst of the pandemic.

The act – which will have far reaching consequences in many areas, as well as the world of insolvency and debt collection – contains a combination of permanent and temporary changes, some of which have been in the pipeline for years, and some of which are being introduced in response to the pandemic.

In order to help businesses trade through a restructuring or insolvency procedure, a permanent measure restricting suppliers from terminating contracts with insolvent customers has been introduced. These termination provisions are likely to be viewed with considerable alarm by suppliers.

What do the termination provisions mean?

While the new provisions have been designed with the best intentions, suppliers should, rightly, be cautious and take ownership of outstanding payments and continued supply.

Termination of any contract for the supply of goods and services to a company – or 'doing any other thing' in respect of that contract – by reason of the company entering into an 'insolvency procedure' is now prohibited. This is also a ban on 'ipso facto clauses' as they are known, which give creditors a right to terminate an agreement on the other party becoming insolvent.

Suppliers can still terminate for other express reasons that are set out in the terms of a contract. For example, where the right to terminate is reserved in the event of payment being outstanding beyond agreed terms. However, if the ability to terminate is available, and the supplier had a right to terminate the contract or supply before the company became subject to an insolvency procedure but did not exercise that right, the supplier may not terminate for that reason during the insolvency period.

Suppliers should, therefore, review their terms and conditions and right to terminate. When entering into new contracts, suppliers should also carefully consider the termination provisions and how these may apply in practice.

The implications if a moratorium is put in place?

One of the permanent changes being introduced is a new option for a debtor company to apply for a moratorium, which will prevent creditors taking certain action against the company for a specified period (usually 20-business days).

Where the supplier cannot terminate, once the moratorium is in place, the supplier is obliged to carry on

supplying to the other party. Suppliers are not allowed to insist on payment of pre-moratorium debts as a condition of any future supply of goods and/or services.

Payments for on-going supply will be payable as an expense in the insolvency process. That is, they will rank above the pre-moratorium debts, which will be subject to a payment holiday, and the other party will not be obliged to pay those debts during the moratorium.

What should suppliers do next?

Suppliers must be proactive and take control. They need to consider the impact of this act on their lending/extension of credit decisions and consider whether they need to amend their documentation and/or working practices.

In terms of credit control and maintaining cash flow, suppliers should protect their position and check if they are using effective credit control methods now to ensure debtors aren't falling behind and outstanding payments aren't increasing without being managed.

Suppliers should also take time to survey the situation of all their customers and make sure no one is putting them at risk. It is worth looking at the terms and conditions to see if they are as robust as they possibly can be – particularly termination clauses.

The act came into force on 26 June 2020 and the provisions have immediate effect. As such, we strongly recommend businesses and lenders consider the effects of the act to ensure that they are fully equipped with adequate legal protection now the changes have come into effect. ☐



Simon Key