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What the offshore contracting industry needs to know about the UK CORPORATE INSOLVENCY AND GOVERNANCE ACT 2020 ("CIGA" or "the Act").

The focus of this note is to consider the impact of this legislation on the marine contracting community, so as to ensure that all stakeholders fully understand the potential issues and thus can prepare themselves to address them should they arise. The aim is to demonstrate, by way of examples that the Act can effect contracts even where the services are being provided outside of the UK or UK territorial waters, and could impact on a contractor's typical rights and remedies.

The Corporate Insolvency and Governance Act came into force on 26 June 2020. The government explanatory notes confirm that the overarching objective of the Act is aimed at ensuring businesses can maximise their chances of survival in light of the COVID-19 pandemic. The intention behind the new provisions is to enable the company to carry on trading through the rescue and restructuring process, with the aim of increasing the likelihood of a corporate rescue or a sale of the business as a going concern[1].

The Act introduces a range of changes to UK insolvency law, one of which is a wide ranging prohibition on the operation of termination clauses in contracts for the supply of goods and/or services where a party enters a "*relevant insolvency procedure*". This legal update focusses on the new restrictions to suppliers' rights to terminate or suspend their contracts with insolvent customers. We consider that services such as surveying, engineering, equipment procurement and installation and conducting repairs (note this is not an exhaustive list) do fall within the definition of supply. We also consider that the wording of the legislation is broad enough to include charterparties.

As we explain below these changes mean that some very common clauses are now unenforceable, even where, in some circumstances, the services are being provided outside of the UK.

A. What do the new provisions do?

1. There is now a permanent prohibition on using the fact that a company has entered an insolvency procedure as grounds for terminating (sometimes referred to as *ipso facto* provisions) or "*doing any other thing*" in respect of, a contract for the supply of goods or services to such company.
2. Switches off automatic termination or other events triggered by insolvency procedure.
3. Suppliers are not permitted to make payment of pre-insolvency arrears a condition of ongoing supply.
4. Inserts new ss.233B and 233C and Schedule 4ZZA in Insolvency Act 1986.
5. Is NOT confined to English companies or English law governed contracts.

B. Who is affected by the new restrictions on termination in the Act?

It will apply to all companies (not confined to English companies or English law governed contracts) that become subject to a "relevant insolvency procedure".

CIGA only restricts the ability of *suppliers* to terminate when their customer has become subject to an insolvency procedure; if you have contracted as a *customer* and you are looking to terminate your agreement with an insolvent supplier, CIGA will not affect you.

[1] See Corporate Insolvency And Governance Act 2020, Explanatory Notes, Policy Background: https://www.legislation.gov.uk/ukpga/2020/12/notes/division/3/index.htm

The restrictions in CIGA only apply to suppliers of *goods and services*.

CIGA will apply if your counterparty/customer goes into a "*relevant insolvency procedure*" - AND - you/your counterparty or your contract is not excluded (there are very limited exclusions listed in section C below).

C. Exclusions

The categories of supplier and categories of contract which are excluded are set out in Schedule 4ZZA of the Act.

Excluded **suppliers** are predominantly suppliers of **financial services** such as banks and insurers.

Excluded **contracts** largely relate to **financial services**.

D. What is a "relevant insolvency procedure?"

The definition of a "relevant insolvency procedure" includes situations where the company (i.e. the supplier's customer):

a. is subject to a moratorium;

b. enters administration or liquidation;

c. has an administrative receiver or provisional liquidator appointed;

d. enters into a voluntary arrangement such as a "CVA"; or

e. is subject to a court order for a meeting relating to a compromise or arrangement.

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.

Does the Act mean that suppliers are forced to continue to supply, come what may?

In short, no. There are still termination options available to suppliers, depending on the specific wording in the contract. The Act does not categorically remove the right of a supplier to terminate a contract for other non-insolvency related breaches. However, the timing of exactly (i) when the terminating event occurred on which the supplier relies and (ii) when a supplier can terminate, are critical. To illustrate this point we focus here on the *BIMCO Supplytime* form.

BIMCO SUPPLYTIME 2017

Hire and Payments

(f) (iii) If after five (5) days of the written notification referred to in Subclause 12(f)(i) the sums referred to have still not been received, the Owners may at any time while such sums remain outstanding terminate the Charter Party.

The wording of Clause 12 provides the owner with a right of termination owing to the outstanding payment of hire. Upon receipt of a written demand for payment, the clause allows the Charterer a five day grace period to make payment. If, for example, a Charterer failed to make payment of hire on day 6, an Owner would be entitled to terminate the charterparty.

Charterer enters administration

For illustration purposes let's now assume that:

a) the Owner delays in terminating the charterparty and does not exercise their right to terminate on day 6; and

b) on day 7 the Charterer goes into administration.

The Act provides that once a party enters insolvency, all past non-insolvency related breaches cannot be relied on to exercise termination. The timing of when this breach occurred is therefore critical; in this example the breach occurred prior to the Charterer entering administration. This would mean that the Owner could no longer terminate for the breach of non-payment of hire. The Act therefore creates a "***use it or lose it***" approach to pre-insolvency events (of any type) giving rise to termination rights.

Recurring breaches

However, if the Charterer continued to not pay hire throughout its insolvency and for example did not pay hire the next month, the Owner would be able to exercise its right of termination pursuant to, in this example, Clause 12 of the *Supplytime* form. The Act provides that if a breach which would have entitled the supplier to terminate prior to the customer's insolvency recurs after the insolvency process begins, it would be regarded as a fresh breach and the supplier could (depending on the terms of the contract) terminate on that basis. This effectively creates a "***clean slate***" approach to termination.

In this regard, it is important for suppliers to ensure that their contract includes clear express wording

setting out (i) when payment is due and payable and (ii) when exactly termination can be effected. If termination can be triggered earlier than insolvency then suppliers should be vigilant and not delay in exercising a right to termination; since if the counterparty enters into an insolvency procedure, the right will be lost unless and until the breach recurs again.

Undue hardship

Lastly, Suppliers can be relieved of the obligation to continue supplies if they agree this with the office holder or company, or if it causes "***undue hardship***" to the supplier's business. A court application would need to be made before the latter of these can be relied upon, so this is not a quick - or very cost effective - route.

The concept of "*undue hardship*" is not defined in the Act, however government guidance on this option suggests that the supplier would need to show a real risk that it would become insolvent itself if it were required to continue supply and that the threshold would be "high"[2]. Our view is that in the near-term, the courts are likely to take a dim view on attempts to terminate contracts which are impacted by the fallout from Covid-19.

E. Illustrative examples

For the purposes of this update we address **four** examples below to enable you to understand the reach of the new provisions in the CIGA.

For the purposes of this update we have assumed that the contract between YOU (the supplier) and your CUSTOMER (the recipient of your services) is in scope of the new Act.

We have therefore assumed that:

a. YOU are a supplier of goods/services;

b. YOU or your CUSTOMER are NOT excluded entities (i.e. suppliers of financial services); and

c. The contract between YOU and YOUR customer is not excluded (i.e. does not relate to financial services).

Examples

I. I am a **UK registered company** providing services in the **UK**. The recipient of those services (my customer) is also a **UK registered company** and enters into **administration** (i.e. a relevant insolvency procedure). Our contract is subject to English law.

- *What can I do and what can I no longer do?*

Termination

i. Terminate on insolvency grounds? **NO**

ii. Terminate on **past** non-insolvency grounds? **NO** (i.e. "*use it or lose it*" approach).

Unless

- Counterparty/customer consents.
- Court grants you a **hardship order**

iii. Terminate on **future** non-insolvency grounds (e.g. non-payment for continued supply)? **YES** (i.e. "*clean slate*" approach).

Something else?

iv. Something other than terminate (e.g. change supply terms, charge default interest)? **NO** (i.e. cannot do "*any other thing*").

v. Withhold supply? **NO** (you cannot make it a condition of continued supply that pre-insolvency debts are paid. However, if the customer fails to pay for post-insolvency supply, you may terminate – see (iii) above).

II. I am a **UK registered company** providing services **outside** the **UK and EU**. The recipient of those services (my customer) is also a **UK registered company** and enters into **administration** (i.e. a relevant insolvency procedure). Our contract is subject to English law.

- *What can I do and what can I no longer do?*

i. Repeat steps in example (I).

III. I am a company registered **outside the UK and EU**, providing services **outside the UK and EU**. The recipient of those services (my customer) is a **UK registered company** and enters into **administration** (i.e. a relevant insolvency procedure). Our contract is subject to English law.

- *What can I do and what can I no longer do?*

i. Repeat steps in example (I).

[2] See House of Commons Library Briefing Paper (June 2020), page 30: http://researchbriefings.files.parliament.uk/documents/CBP-8922/CBP-8922.pdf.

IV. I am a company registered **outside the UK and EU**, providing services **outside the UK and EU**. The recipient of those services (my customer) is a company registered **outside the UK and EU** and enters into **administration** (**outside the UK and EU**). Our contract is subject to English law.

➢ *What can I do and what can I no longer do?*

- In this example it is important to note that (i) neither you, nor your customer are based in the UK or EU and (ii) your customer has entered administration **outside the UK and EU**.

- If the customer is subject to overseas insolvency proceedings these would <u>not</u> be classed as "*relevant insolvency proceedings*" (as per the CIGA). In this example CIGA would <u>not</u> apply - the options available to you in this example are therefore different:

No "relevant insolvency procedure"

<u>Termination</u>

i. Terminate on insolvency grounds? **YES**
ii. Terminate on **past** non-insolvency grounds? **YES** (i.e. "*use it or lose it*" approach).
iii. Terminate on **future** non-insolvency grounds (e.g. non-payment for continued supply)? **YES**

<u>Something else?</u>

iv. Something other than terminate (e.g. change supply terms, charge default interest)? **YES**
v. Withhold supply? **YES**

- However, there may be certain rights available to the foreign customer depending on its specific circumstances – these are discussed in the next section.

F. Can my overseas customer rely on CIGA in any way?

There are however **three** possible ways in which your counterparty/customer could bring themselves within the ambit of CIGA and could therefore protect themselves from termination by you for reason of insolvency grounds.

It is possible that the customer's insolvency outside the UK and EU could become a **cross-border recognition** issue.

In the UK, this regime is governed by the *Cross-Border Insolvency Regulations 2006* (CBIR). The CBIR envisage that a "foreign representative" (usually a foreign insolvency office holder) can seek assistance from the English courts and make an "application for recognition" in connection with the foreign insolvency proceedings.

If your counterparty/customer were successful in being "*recognised*" by the English courts, the foreign representative could:

d. Apply for an "automatic stay" to prevent certain types of creditor action against any assets in the UK (i.e. commencing insolvency proceedings in the UK). If successful, the customer <u>would</u> be able to rely on CIGA by reason of initiating a "relevant insolvency procedure".

e. Request "appropriate relief"[3] from the English court. It is conceivable that if the foreign jurisdiction in which the customer has entered insolvency has laws which invalidate *ipso facto* clauses in contracts (i.e. a similar provision to the new s.233B and s.233C CIGA), then the English court would be empowered to apply such a provision (at its discretion) to the contract.

The English court is empowered to intervene and wind-up an overseas company. The matter is at the court's discretion, however the following core principles will be considered by the court:

f. the company must have sufficient connection with England and Wales (does not necessarily have to consist of assets within the jurisdiction);

g. there must be a realistic prospect that the winding up order will benefit the applicant; and

h. the court must be satisfied that it has jurisdiction over at least one person interested in the distribution of the company's assets.

In this regard, the invalidation of *ipso* facto provisions in CIGA will only affect a foreign customer (based outside the UK and EU) if:

1) The customer's foreign insolvency proceedings are "recognised" by the English courts: the customer is successful in commencing insolvency proceedings in the UK (i.e. it has assets in the UK which it wishes to protect from creditor action).

2) The customer's foreign insolvency proceedings are "recognised" by the English courts: the jurisdiction in which the customer has entered administration has similar provisions to s.233 CIGA (invalidating *ipso facto* clauses in

[3] A.2 of Sch.1 of the CBIR 2006

contracts) AND the courts are prepared to utilise their powers of "appropriate relief" and apply such provisions in the UK.

3) The court exercises its power to wind-up a foreign company (if the company has a sufficient connection to England and Wales).

G. What should I do, as a supplier, going forward?

Given that such express rights tend to be drafted quite widely and often on different terms we do recommend that suppliers conduct a careful review of these clauses before entering into any new service contracts. It may well be that the suppliers own terms of business need to be adjusted as a result of such a review.

In our view, it's still worth including rights for a supplier to terminate on a customer's insolvency, both in standard terms and in negotiated agreements, if only to preserve the possibility that either an office-holder or the court would allow termination via the statutory route. However what is import to identify and understand what alternative protections, which are independent and enforceable, are built into the wording.

A supplier should ensure that they are able to terminate on non-insolvency grounds as swiftly as possible:

1) Spot early warnings: monitor the company's financial position to enable you to identify and trigger termination of the contract before it enters into an insolvency procedure. It may be sensible to include in the contract requirements for the company to notify you of their financial position at key points, to enable you to take action. (Also remember that a notice from your customer of their intention to appoint an administrator would not trigger the CIGA – the customer must have actually entered administration).

2) Take a stricter approach to breaches of contract: if a right to terminate accrues, don't delay in exercising it. If the company enters into an insolvency procedure, the right will be lost.

3) Make sure your contract includes rights to terminate which are not based on insolvency, or which are triggered earlier than insolvency.

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