SQUIRE PATTON BOGGS

The Impact of The Corporate Insolvency and Governance Act (CIBA) on Corporates

Your Questions Answered

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At our webinar on 2 July 2020 we examined the impact of the CIGA for corporates engaged with third parties who might enter into an insolvency process.

We have put together this question and answer sheet responding to the questions raised which, together with our quick guides, will help corporates understand the issues and challenges that the new processes and procedures could pose.

In light of these changes and looking towards how trading post-COVID 19 might impact supplier relationships, now is an opportune moment for corporates to review supplier contracts, refresh terms and conditions and update credit control procedures to mitigate any adverse effects on healthy businesses moving forward.

To discuss any of these questions or how we can help your business to adjust to these changes please contact any one of our speakers whose contact details are below.

This question and answer sheet is not intended to, and does not, constitute legal advice and Squire Patton Boggs (UK) LLP accepts no liability for any losses occasioned to any person by reason of any action or inaction as a result of its contents.

Ipso Facto

Can suppliers who cannot terminate their contracts and have to supply during an insolvency insist on a personal guarantee?

In short, no. Any supplier who is required to continue supplying goods or services through the period of the corporate moratorium should be paid by the company for those goods or services when payment falls due.

If payment is not made and the company then enters administration or liquidation the unpaid debt is paid as an expense of the administration or liquidation ahead of amounts outstanding to most other creditors. Therefore, the supplier should be paid for supplies made post insolvency but may have to wait for payment.

In an administration or liquidation supplies made during that period are payable as an expense. Again, this means that the supplier should be paid, and ordinarily is paid when payment falls due but they may have to wait for payment.

In both cases *ipso facto* suppliers should be paid ahead of the relevant insolvency practitioner's fees.

Finally, suppliers can, if they will suffer hardship as a result of the *ipso facto* regime apply to court for an exemption under the hardship rules. This is likely to cover situations where being forced to continue supplying will cause significant financial distress for the supplier.

What is the impact on standard termination clauses, which are triggered by an insolvency event?

The effect of *ipso facto* essentially means that such clauses are ineffective. You can no longer rely on an insolvency event to terminate the contract. Nor can you rely on a pre-existing right to terminate- such as a failure to pay an invoice that was overdue before the company entered into an insolvency process. If there were unpaid invoices at the point of insolvency but you did not exercise your right to terminate for non-payment before insolvency, you cannot now terminate the contract post insolvency.

However, if the company (or insolvency practitioner – depending on the process) fails to pay for supplies made post-insolvency, you can terminate the contract at that point it the terms of your contract allow termination for non-payment. You may wish to review your credit control process to ensure that payment is monitored, both pre and post insolvency.

One point to note, is that the *ipso facto* provisions bite when the company enters into an insolvency process. If a company is proposing to enter administration there may be an opportunity to terminate before it does so. It is only when the company files a notice of appointment that the regime applies, therefore if a supplier learns that its customer has filed a notice of intention to appoint administrators and wishes to terminate, then provided the supplier exercises its right to terminate before administrators are appointed they can do so.

Do the ipso facto provisions apply to just UK contracts, for example, do they impact overseas companies in contracts with UK suppliers or suppliers to overseas companies?

If your customer is based overseas and enters into an insolvency process, then the UK *ipso facto* regime will not apply and you can terminate the supply contract for insolvency related events. That is, unless the insolvency law in the country where your customer has entered into an insolvency process has its own *ipso facto* laws. For example, Australia has similar restrictions on terminating supply contracts.

If you are an overseas supplier to an English company, it appears that the UK *ipso facto* regime will apply because on the face of it the provisions apply to all contracts regardless of where the supplier is based. If it does apply, the biggest difficulty will be a practical one in terms of enforcement and the cost of that. If the overseas supplier refuses to supply then this is likely to require the support of the local foreign court to force the overseas supplier to continue to supply.

One area that is unclear is the position where the contract is not governed by UK law. If it is, (you will need to check the jurisdiction clause in the supply contract to see which law applies) then the *ipso facto* regime will apply. But if it is not, it is unclear whether UK insolvency law or the contractual provisions prevail. We will have to see how the UK courts deal with this question but is perhaps advisable to proceed on the basis that the prohibition might apply.

If you are the customer, and your supplier goes into insolvency, are you still prevented from terminating, and finding a new supplier?

No, the *ipso facto* regime only affects suppliers of goods and services to insolvent companies. If your supplier enters an insolvency process, you can terminate the contract and find a new supplier.

Would professional advisers who were already in place advising the business on issues in general, be required to continue to advise: a) on general issues; b) on issues specifically in relation to the insolvency?

The *ipso facto* regime only applies to those supply contracts where there is a continuing obligation to supply, so, for example, where the supplier is under an obligation to supply a minimum quantity of goods each week the supplier would have to continue to meet that obligation even if its customer had entered into an insolvency process.

Where there is no obligation, the supplier decides whether to accept an order or continue to provide the services.

For professional advisers they will need to consider the terms of their engagement letter to determine the extent of the retainer and in what circumstances they can terminate. If the only reason is non-payment, then ipso-facto would prevent termination on that basis.

Moratorium

How will I find out about a moratorium?

The company is obliged to file documents at court to obtain a moratorium and you may be able to find out from the court (or by ringing the central winding up index 0906 754 0043) whether a moratorium is in place.

In addition, once the company is in a moratorium the appointed monitor must notify all creditors that a moratorium is in place and must also notify Companies House. Therefore, creditors should receive notification directly or can search Companies House to find out if there is a moratorium in place but there may be a delay between receiving notice and the start of the moratorium.

Further, once the moratorium is in place the directors are obliged to state on all invoices, orders, business letters and order forms that a moratorium is in place. They must also include a statement on the company's website.

What do I do if the company in a moratorium isn't paying me?

If the company has not paid for goods or suppliers supplied during the moratorium as and when they fall due and if the supply contract allows termination for non-payment then the supplier can terminate the contract.

The unpaid moratorium debt is 'protected' to a degree because if the company subsequently enters into administration or liquidation then the debt is payable ahead of all other costs and expenses in the administration or liquidation. If the company enters into a company voluntary arrangement (CVA) or restructuring plan (RP) then the debt cannot be compromised/crammed down and will have to be paid in full if the CVA or RP is approved/sanctioned. However, that only applies to payments falling due for supplies made during the moratorium. Debts that were outstanding at the point of insolvency will be unsecured claims in a subsequent insolvency process.

In both scenarios a supplier will need to factor in that there may be a delay in receiving payment and a risk of receiving no payment at all if the restructuring process fails or there are insufficient funds.

Would any recovery proceedings commenced pre-moratorium be automatically stayed once a company enters the new moratorium?

Yes, any action or legal proceeding is automatically stayed. Whilst a creditor can apply to court for permission to lift the stay, this is only in respect of trade debts incurred post-moratorium.

Will the provisions prevent set off?

No, set off is specifically excluded from the *ipso facto* regime. Therefore if there is a contractual, common law or other right of set-off those rights can still be exercised.

There seems to be an exception for recovery of pre-moratorium debts of up to £5,000 with consent of the monitor. Is that £5,000 per supplier, or £5,000 for all debts owed by the company?

It is £5000 for all debts owed by the company. The company can pay more than one person and make more than one payment, but can only pay up to a maximum of £5000 without the monitor's consent. The threshold is actually the greater of £5000 and 1% of the value of unsecured debts owed by the company at the start of the moratorium.

However because the company benefits from a payment holiday from pre-moratorium trade debts it does not have to pay. This is entirely at the company's discretion. The trade creditor on the other hand, (because of the moratorium) cannot take recovery action.

If a supplier is not caught by the *ipso facto* regime, but the company places an order, it might therefore be possible to negotiate that your pre-moratorium debt (up to the threshold) is paid as a conditions of agreeing to fulfil that order.

The monitor can consent to the company paying over the threshold but has to be satisfied that the payment (or payments) will support the rescue of the company as a going concern. If you are a key supplier to the business, there may be room to negotiate and recover your pre-moratorium debt.

Does ipso facto prevent a customer exercising step in rights in the event of its supplier becoming insolvent?

No, the *ipso facto* provisions only apply to the suppliers of goods and services, not the recipient of those goods and services.

Statutory Demands

If statutory demands and winding up petitions are restricted, what other debt recovery options do you have?

It is still possible to issue ordinary debt proceedings in court but if defended, these could be time consuming and expensive because of the need to comply with directions (e.g, disclosure, witness evidence and expert evidence). They also carry a cost risk.

One option could be to trying to agree that as condition of continuing to supply that your customer grants security for the debt and any future debts via a charge/debenture, but these could be vulnerable if the debtor company goes into insolvency within 12 months of the security being taken. Alternatively (or in addition) you could seek a personal guarantee from the directors or a guarantee from the company's parent company.

Statutory demands and winding up petitions can be used to collect unpaid debts but they should only be used if where a creditor is pursuing payment of an undisputed debt. Once the temporary restrictions end (currently 30 September 2020) then a creditor can both serve a statutory demand and present a petition to winding up the company regardless of the reason for non-payment. At the moment, a petition can only be presented if the reason for non-payment is not COVID-19 related. There is therefore a real cost risk to presenting a petition whilst the temporary restrictions are in place.

Wrongful Trading

What other deterrents are there to prevent a director of an insolvent company continuing to trade recklessly during this period?

Directors have a number of other duties under the Insolvency Act (not to give preferences or enter into transactions at an undervalue) as well as duties under the Directors Disqualification Act and under the Companies Act (including an almost identical duty not to trade whilst insolvent) which are not being relaxed. Directors can also still be liable for misfeasance.

Accordingly, our advice to directors of distressed companies is not to act differently as a result of this temporary measure – they should continue to act honestly and reasonably in the best interest of creditors – and therefore we do not expect directors behavior to change as a result of the wrongful trading provisions being relaxed.

Restructuring Plan (RP)

If I receive a proposed RP and think it is being used to isolate us from the decision making process what should our next steps be?

If it is clearly unfair against a specific creditor you would have an opportunity to put your case to the court. Can you demonstrate e.g. that putting you in a certain class was wrong, the valuation of your interest is wrong, or you would do better in, say, an administration or an alternative RP?

The courts also have the power to decide even if all criteria is technically met, whether or not to sanction the RP. They may conclude it is not just and equitable.

Another thing you might look at is putting forward your own RP to rival the one you have been presented with, although we would suggest it would need to be sufficiently financially prejudicial to justify what will be quite a significant cost of going down that route.

Contacts

John Alderton
Partner, Leeds
T +44 113 284 7026
E john.alderton@squirepb.com

Russ Hill
Partner, Birmingham
T +44 121 222 3132
E russell.hill@squirepb.com

Devinder Singh
Partner, Birmingham
T +44 121 222 3382
E devinder.singh@squirepb.com

Mark Prior
Director, Manchester
T +44 161 830 5266
E mark.prior@squirepb.com

Rachael Markham
Senior Associate, Leeds
T +44 113 284 7531
E rachael.markham@squirepb.com