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## What the commodities industries need to know about the Corporate Insolvency and Governance Act

**This note considers how the recent changes to UK insolvency law introduced by the Corporate Insolvency and Governance Act 2020 ("CIGA") might affect those involved in the sale and purchase of commodities. In particular, it looks at the impact of Section 14 of CIGA on contracts for the supply of goods or services, and on the typical rights and remedies of the seller / supplier under such contracts.**

CIGA came into force on 26 June 2020 and introduces a series of changes to UK insolvency law. The changes represent a shift toward a business rescue culture more in line with a number of other jurisdictions, including the United States and Chapter 11 proceedings under the Bankruptcy Code. Significantly, pursuant to Section 14 of CIGA, suppliers of goods and services are now unable to rely on so called *ipso facto* clauses (provisions that permit termination due to the bankruptcy, insolvency, or financial condition of a party), even, in some circumstances, where the 'customer' is based outside of the UK. However, this change does not apply to all types of suppliers, nor does it apply to every type of contract for the provision of goods and services, and we focus herein on the scope of the exception relating to commodities contracts.

### An overview of the key aspects of Section 14 of CIGA

Section 14 of CIGA introduces new Sections 233B and 233C and a new Schedule 4ZZA to the Insolvency Act 1986 (the "IA"). The key parts of Section 14 provide that:

1. Any (automatic or elective) termination clause contained in a contract for the supply of goods and services is ineffective when the customer (the "**Company**") becomes subject to a '*relevant insolvency procedure*'.<sup>1</sup> The clauses affected by this provision are those which:
  - provide that the contract or supply would terminate, or "*any other thing would take place*", because the Company becomes subject to the insolvency procedure (i.e. a termination provision which is triggered automatically upon the Company's entry into the insolvency procedure); or
  - entitle the supplier to terminate the contract or supply, or "*do any other thing*", because the Company becomes subject to the insolvency procedure (i.e. an elective termination right that arises upon the Company's entry into the insolvency procedure).  
(the "**Prohibition**").
2. Upon the commencement of a 'relevant insolvency procedure' a supplier is:
  - prohibited from terminating the contract/supply if a breach and a right to terminate arose, but was not utilised, prior to the Company entering such an insolvency procedure (Section 233B(4) of the IA); and
  - prohibited from making it a condition of continued (post-insolvency) supply that outstanding charges in respect of a supply

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<sup>1</sup> 'Relevant insolvency procedure' is defined in Section 233B(2) of the IA.

made before entry into the relevant insolvency procedure are paid (or do anything which has the effect of creating such a condition of continued supply) (Section 233B(7) of the IA). The aim is to prevent suppliers from holding their customers to ransom by threatening to cut off essential supply or demanding priority payment of pre-insolvency arrears in return for continued supply.

3. depending on the insolvency procedure in question, termination may still be permitted by CIGA if the insolvency practitioner or Company consents, or the court is satisfied that not terminating would cause the supplier *'hardship'* and grants permission to the supplier to terminate (Section 233B(5) of the IA).

The new Schedule 4ZZA to the IA (the provisions of which are contained in Schedule 12 of CIGA) provides for certain suppliers and contracts to be excepted from the provisions of Section 14 and we consider this further below under the heading "Exclusions".



### What is "any other thing"?

The Prohibition also applies where a contract provides for "*any other thing*" (other than termination) to take place as a result of the Company's entry into a 'relevant insolvency procedure'. This applies equally where the contract:

- 1 provides for the automatic triggering of '*any other thing*' to take place as a result of a Company's entry into a 'relevant insolvency procedure', and

- 2 provides for a contractual entitlement of the supplier to do "*any other thing*", because a Company has entered a 'relevant insolvency procedure'.

"*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 may capture the exercise of any contractual right triggered by a Company's entry into a relevant insolvency procedure. Some obvious examples of "things" that would likely be caught by this wording include compelling the Company to make higher payments or changing payment terms to provide for payment on delivery.

### Can a supplier still terminate its contracts if its 'customer' becomes insolvent?

Under Section 14 of CIGA<sup>2</sup>, a supplier may still terminate under a clause which would otherwise be subject to the Prohibition where:

- a. the Company or the office holder consents to the termination of the contract, or
- b. upon application, the Court is satisfied that the continuation of the contract would cause the supplier *"hardship"*.

The concept of "hardship" is not defined in CIGA, however Government guidance indicates that it is likely to mean the possible insolvency of the supplier should it be forced to continue the supply. Suppliers should be aware that the *'hardship'* route has been described in The Commons Library analysis of the Bill<sup>3</sup> as a 'safeguard of last resort'.<sup>4</sup>

Suppliers will also be able to terminate their contracts before the Company enters into the 'relevant insolvency procedure' for an event which occurred before the insolvency period<sup>5</sup>, or where a breach occurs and the right to terminate arises during the insolvency period (if the breach is not the fact that the Company has become subject to a relevant insolvency procedure). A Supplier cannot, however, terminate a contract during the insolvency period, where the entitlement to do so arose before entry into the relevant insolvency procedure.

<sup>2</sup> See Section 233B(5) of the IA

<sup>3</sup> (note that this predates CIGA coming into force)

<sup>4</sup> See House of Commons Library Briefing Paper (June 2020), page 30: <http://researchbriefings.files.parliament.uk/documents/CBP-8922/CBP-8922.pdf>.

<sup>5</sup> The insolvency period is defined by reference to when the Company became subject to the relevant insolvency procedure and ending according to different specified events, i.e. when a moratorium comes to an end or when the appointment of an administrator ceases to have effect (See Section 14 (8) of CIGA).

## Exclusions

The categories of supplier and contract exempted from the restrictions in Section 14 are inserted by CIGA into Schedule 4ZZA of the IA.

Excluded **suppliers** are predominantly suppliers of **financial services**, such as banks and insurers, but also include clearing houses.

Pursuant to paragraph 13(2) of Schedule 4ZZA, **'Financial Contracts'** are excluded. The list of 'Financial Contracts' includes reference to 'commodities contracts' and 'futures or forwards contracts' as follows (our emphasis):

"(c) a **commodities contract**, including—

(i) a contract for the **purchase, sale or loan** of a commodity or group or index of commodities for **future delivery**;

(ii) an **option** on a commodity or group or index of commodities;

(iii) a **repurchase or reverse repurchase transaction** on any such commodity, group or index;

(d) a **futures or forwards contract**, including a contract (other than a commodities contract) for the purchase, sale or transfer of a commodity or property of any other description, service, right or interest for a specified price at a future date;"

There is no definition of 'commodities' in Schedule 4ZZA although, being guided by ancillary legislation<sup>6</sup>, it is possible that the definition will cover *'goods of a fungible nature that are capable of being delivered, including metals (and their ores and alloys), agricultural products and energy such as electricity'*. Since this definition refers to goods which are 'fungible' (i.e. mutually interchangeable/generic) and also 'energy', we consider that Schedule 4ZZA includes other commodities such as oil products and coal.

By way of example, therefore, a sale and purchase agreement for the physical sale of steel for future delivery might be exempted from the Prohibition under paragraph 13(2)(c)(i) of Schedule 4ZZA.

The wording in brackets in sub-paragraph 2(d), *'other than a commodities contract'*, presents a certain ambiguity. We expect to see disputes as to whether the words *'other than'* operate to exclude certain commodities contracts from paragraph 13 (with the result that they are caught by CIGA). Perhaps the most common-sense interpretation, considering the purpose of the 'Financial Contracts'

exclusion, is that the wording in brackets is simply making it clear that the exemption in 13(d) is in addition to and/or does not limit the exemption in paragraph 13(c).

There is a further exemption for 'spot contracts' under Paragraph 16 of Schedule 4ZZA. 'Commodities contracts' which do not have a future delivery date may be exempted under this separate paragraph, although this will merit careful consideration.



## Can an overseas Company rely on the Prohibition in CIGA?

If a company is based outside the UK and enters a foreign insolvency procedure (outside the UK), that will not be a 'relevant insolvency procedure' under CIGA. Notwithstanding this, there are ways in which an overseas company could still bring itself within the ambit of Section 14 and the Prohibition in CIGA and could therefore protect itself from termination by the supplier on insolvency grounds:

- 1 If the Customer is an 'eligible company', as defined in Schedule ZA1 to the IA, and has a 'sufficient connection' to England or Wales, it might be able to apply for and obtain (at the Court's discretion) a moratorium pursuant to Section 1, A5 of CIGA.
- 2 If the Customer's foreign insolvency becomes a cross-border recognition issue. The Cross-Border Insolvency Regulations 2006 ("CBIR") permit a foreign insolvency officeholder of a company to apply to the English Courts for 'recognition' of the foreign insolvency procedure and, in applying for 'recognition', to request 'additional relief that may be available to a British insolvency officeholder under the law of Great

<sup>6</sup> See Article 2(6) of the Commission Delegated Regulation of 25.4.2016 supplementing Directive 2014/65/EU

Britain'.<sup>7</sup> With the introduction of CIGA, and following the reasoning of the Court in Pan Ocean,<sup>8</sup> a request by a foreign Company in foreign insolvency proceedings to the English Court to restrain a supplier from terminating an English law supply contract pursuant to an *ipso facto* clause is now more likely to be granted as a form of 'additional relief'.<sup>9</sup>

- 3 Under Part V, Section 221 of the IA, any unregistered company (including a foreign company) may be wound up by the Court. A leading English law case<sup>9</sup> stated three core requirements to determine if the Court has the jurisdiction to do so, one being that the company must have a 'sufficient connection' with England and Wales.

### What should suppliers do going forward?

We recommend that parties conduct a careful review of termination clauses before entering into new contracts for the supply of goods or services, and consider whether their own general terms and conditions of sale / supply, or indeed those of their counterparty, need to be amended.

Some ways in which sellers / suppliers might protect themselves given the new protections afforded to buyers / customers under CIGA are:

- 1 Undertake enhanced due diligence on any new counterparties. Be aware of your counterparty's financial status, as well as any connections it has with England or Wales such that CIGA might apply to them either directly, or by way of the CBIR, or because the courts in England or Wales might have the jurisdiction to wind them up.
- 2 Identify early warnings of financial difficulties. Include provisions in your contracts that enable you to monitor your counterparty's financial position, such as an obligation to notify you of an intention to appoint an administrator, or to inform you of the financial standing of the company at key points during the term of your contract. This will enable you to identify financial distress and exercise any accrued termination rights before your counterparty officially enters into an insolvency procedure.
- 3 Consider renegotiating existing contracts to include alternative protections such as extended rights to terminate for non-insolvency events, earlier termination triggers, and/or advance

payment terms or shorter invoicing/payment periods.

- 4 Ensure you have been provided with the security you require from your counterparty, and that the 'trigger' for being able to call on your security is properly worded (i.e. is not related to entry into an insolvency procedure).
- 5 Ensure that termination provisions clearly define when breaches will occur and/or recur, and when termination rights will arise.
- 6 Take a stricter approach to breaches of contract. If a right to terminate accrues, do not delay in exercising it. If your counterparty enters into an insolvency procedure, the right may be lost.

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<sup>7</sup> See Articles 20 and 21 of the CBIR

<sup>8</sup> *Fibria Celulose S/A v Pan Ocean Ltd* [2014] BUS LR 1041

<sup>9</sup> *Real Estate Development Co* [1991] BCLC 210