

“Insolvent Abuse” – Restrictions on Rights to Terminate for Customer Insolvency

On 26 June 2020, the Corporate Insolvency and Governance Act 2020 (CIGA 2020) significantly restricted suppliers' rights to terminate or suspend their contracts with insolvent customers. The changes mean that some very common clauses are now unenforceable. The new law needs to be kept in mind when negotiating new contracts, as well as when enforcing or managing existing contracts. For a wider view on the effects of CIGA 2020, see [Joanna Ford's blogpost](#).

The Background

There is no automatic right to terminate a contract if the other party becomes insolvent. As a result, many contracts include termination rights for one or both parties if the other becomes insolvent (often listing out specific insolvency events which trigger this right). This allows the non-insolvent party the option of terminating and reducing their exposure, even if the insolvent party is still complying with the contract. Although similar restrictions already applied to suppliers of certain essential services (such as utilities and some IT services), this new law extends restrictions to all types of supplier.

The change

The new law restricts a supplier's right to terminate or suspend supply where their customer is subject to specified insolvency procedures. Customer rights to terminate for supplier insolvency are not restricted. There are two main restrictions.

No termination or other rights or events can be triggered by insolvency

Any provision of a contract will cease to have effect if it would be triggered by the customer being subject to an insolvency procedure. So a right for the supplier to terminate, or change payment terms, or suspend its supply, would have no effect. This is still the case if the provision takes place automatically, without the supplier having to exercise a right.

No termination for breaches before the insolvency procedure

Any right under a contract for the supplier to terminate or suspend the contract because of an event occurring before the insolvency procedure started cannot be exercised once it has started. So if a customer had overdue invoices prior to the insolvency procedure, you cannot rely on that to terminate once the insolvency procedure starts. However you can terminate before the insolvency procedure starts, or terminate if a trigger occurs after the insolvency procedure starts.

What is an insolvency procedure?

The new law sets out a list of specific insolvency procedures which are relevant:

- a moratorium comes into force for the customer (a new insolvency process introduced by CIGA 2020);
- the customer enters administration;
- an administrative receiver of the customer is appointed (otherwise than in succession to another administrative receiver);
- a voluntary arrangement takes effect in relation to the customer;
- the customer goes into liquidation;
- a provisional liquidator of the customer is appointed (otherwise than in succession to another provisional liquidator); or
- a court order is made in relation to the customer summoning a meeting relating to a compromise or arrangement (under section 901C(1) of the Companies Act 2006).

So how can I terminate once an insolvency procedure has started?

Suppliers can still terminate if their termination right arises after the insolvency procedure starts. Suppliers can also terminate if the company or the relevant insolvency practitioner agrees, or they can apply to court for permission to terminate.

Are there any exclusions?

Contracts are excluded if the customer or supplier is a financial services company.

Next steps – practical measures

These restrictions mean suppliers need to consider how best to protect themselves from the risks associated with insolvent customers. In particular:

- Due diligence on customers prior to any big supply commitments – consider whether committing to supply a customer is worth it;
- Ongoing monitoring of customers' financial position and payment status – a search at the High Court will flag any issued proceedings at an earlier stage. We are happy to run a search at the High Court if you let us know. Please contact [Jo Ford](#) for help;
- Consider prompt enforcement action if a customer may soon become insolvent (rights can still be exercised prior to the insolvency procedure starting); and
- Make sure contract administrators are aware of whether these restrictions apply. Attempting to terminate under a clause which is unenforceable could lead to the customer having a right of action against you for damages.

Next steps – contract clauses

As these changes are still relatively new, it's not yet clear how widely the courts will interpret these restrictions, and what clauses will be most effective at protecting suppliers. While triggers based on insolvency procedures are unlikely to be enforceable, suppliers may want to consider provisions allowing them exercise rights other than termination (for instance, changing payment structures) if certain triggers other than insolvency (for instance, late payment) occur. The focus should be on reducing exposure and risk, rather than terminating the contract entirely.

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