Ipso Facto Reform

Why now, and does it go too far (or not far enough)?

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Felicity Toube QC and Georgina Peters consider the CIGA reform to *ipso facto* (termination) clauses

"England and the US are two countries united by the common law but divided by their approach to anti-deprivation principles". When the late Gabriel Moss QC wrote these words in 2017[1], the world looked rather different. Robustness of commercial supply chains of toilet paper was not headline news. Legal debate on the UK's *ipso facto* divergence from other jurisdictions centred on the flexibility of our anti-deprivation principle. Practitioner opinion was weighted in favour of the view that a US-style ban on *ipso facto* clauses in executory contracts would never be implemented in this jurisdiction – underscored by the generous approach of the courts to permitting contractual clauses which deprive the insolvency estate of assets[2] and the firmly entrenched principle of freedom of contract into which English insolvency law had made the most limited of inroads.

Fast-forward to 2020. *"Never say never"* should be our current buzzphrase. A new law – the Corporate Insolvency and Governance Act (CIGA) – has been legislated at accelerated pace, and the COVID-19 pandemic has infected the debate. The CIGA contains an *ipso facto* ban with regard to supplier contracts. In this article, we summarise the amendments to existing law, consider the practical impact of the reform and issues likely to arise, and question the policy objectives underlying the change.

In particular, we ask whether the mindset has really changed, and if so why? We also consider whether the reform is really that radical: is it a timid extension of existing law, or a virulent interference with long-held contractual principles? And given the potential for sustained economic damage (absent significant government intervention), do age-old debates about interference with contractual freedom now look rather quaint, and can a principled case for the reform still be made?

Ipso facto clauses

At their simplest, *ipso facto* clauses apply on the occurrence of an insolvency event or on the potential insolvency of one party. They will either terminate the contract (constituting an event of default) or impose altered terms. Contractual termination may be automatic or (more usually) may occur at the other party's election. *Ipso facto* clauses apply regardless of whether the distressed party has otherwise breached any contractual terms or remains capable of fully discharging its obligations, and are of widest import in executory contracts (contracts where either or both parties have outstanding performance obligations).

In the wake of the Lehman collapse, the courts (both UK and US) were presented with complex clauses found in finance agreements. However, *ipso facto* clauses do not just raise issues for large companies, but will be relevant for companies of any size. They will also relate to a whole range of supplies, including distribution rights, intellectual property, and insurance.

Plainly, these clauses work to the advantage of the terminating party and to the disadvantage of the party in financial distress. The terminating party can decide whether it wishes to become entangled in the affairs of the latter, or abandon the contract without concern. More particularly, the terminating party need have no concern about the consequences for the viability of its counterparty's business, or for its survival.

Ipso facto clauses also pose significant challenges to formal insolvency processes. The insolvent company becomes vulnerable to ransom creditors (holding-out for payment of arrears) or loss of supply. The operation of these clauses can therefore undermine rescue efforts and (if supply is lost) may prevent the company from remaining operational.

Given the (usually adverse) effect of *ipso facto* clauses on the insolvent party's ability to restructure and survive, many jurisdictions have prohibited (to a greater or lesser extent) the operation of the *ipso facto* clause. In particular, we find such prohibitions enshrined in the US under Chapter 11 of the Bankruptcy Code[3], in Canada, and (since 2018) in Australia. The new EU Restructuring and Insolvency Directive[4] also affords debtor protection against *ipso facto* clauses. Until now, however, such clauses have remained valid in English law (subject to certain protections for creditors, primarily arising out of the anti-deprivation principle and *pari passu* rule).

Sanctity of freedom of contract

The main justification for protection of *ipso facto* clauses is that since at least the 19th century, it has been a fundamental principle of English law that parties are free to contract as they may think fit. In entering into contracts, parties have been free to decide when, and in what circumstances, the contract will come to an end: whether that is upon breach by one party of one or more of their contractual obligations, or simply by virtue of the fact that a given event or state of affairs comes to pass.

Two judicial statements, from 1874 and 2011 (at the highest appellate levels), show how firmly entrenched the principle of freedom of contract has been:

"... if there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice. ***Therefore, you have this***

1. *"Anti-deprivation, flip clauses, ipso facto rules and the Dante inferno"*, Gabriel Moss QC, Insolv. Int. 2017, 30(2), 24-27, 24.

2. Being a "deprivation" within the meaning of the anti-deprivation principle. Most notably, in 2012 the Supreme Court held that an arrangement might not contravene the anti-deprivation principle if it is a *bona fide* commercial transaction entered into for reasons other than an intention to evade insolvency laws: *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383 (SC).

3. Ss 363(I) (right to use property of the estate), 365(e) (executory contracts) and 543(c) (debtor's interest in property).

4. Directive (EU) 2019/1023, O.J. L172/18, art 7.

paramount public policy to consider – that you are not lightly to interfere with this freedom of contract*" (Printing and Numerical Registering Co v Sampson*[5]*, per* Sir George Jessel MR)

"***Despite statutory inroads, party autonomy is at the heart of English commercial law*** *... it is desirable that, so far as possible, the courts give effect to contractual terms which parties have agreed. And there is a particularly strong case for autonomy in cases of complex financial instruments such as those involved in this appeal" (Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd*[6]*, per* Lord Collins) (emphasis added)

Current position

In this context, reform in 1986 and 2015 had been limited and incremental – and when a ban on *ipso facto* clauses was proposed in the standing committee stage of (what became) the Enterprise Act 2002, it was rejected.

Prior to the CIGA, the only restrictions were on insolvency-related terms in contracts for the supply of "*essential goods or services*": being gas, water, electricity, communications services and certain other (identified) electronic supplies (e.g. Wi-Fi, and chip-and-pin devices). For these supplies:

- During the course of any insolvency procedure under the Insolvency Act 1986 (the IA), a supplier is entitled to make it a condition of continued supply that the officeholder personally guarantees payment of any charges (s 233(2)(a)), but cannot demand payment of pre-insolvency arrears as a condition of supply (s 233(2)(b))[7].
- This was a 1986 reform instituted by the IA, to prevent suppliers holding officeholders to ransom (a threat to cut-off essential supply), and stealing a march on other creditors (even preferential) by demanding priority payment of pre-insolvency arrears in return for continued supply.

A first, limited, turning-point came in 2015: by the Insolvency (Protection of Essential Supplies) Order 2015[8], which introduced a new s 233A into the IA[9]. Under that section:

- If a company enters administration or is subject to a CVA, "*an insolvency-related term of a contract*" for the supply of "*essential*" goods or services ceases to have effect (s 233A(1)). This includes a contractual provision triggered by the company entering administration or being subject to a CVA (s 233A(8)),

(1) Providing for the contract or supply to terminate, or *"any other thing to take place"*;

(2) Entitling a supplier to terminate the contract or supply, or *"do any other thing"*.

- It also includes a contractual provision which entitles a supplier to terminate the contract or supply *"because of an event that occurred"* <u>before</u> the company enters administration or a CVA takes effect (s 233A(8)). However, it does not include a term which entitles termination *"because of an event that occurs, or may occur"* <u>after</u> the company enters administration or a CVA takes effect (s 233A(2)(c)).
- There are two sets of carve-outs:

(1) First, the supplier is still allowed to terminate the contract with the consent of the administrator or supervisor, with court permission, or if any charges for post-insolvency supply are not paid within 28 days

5. (1874-1875) L.R. 19 Eq. 462, 465.

6. [2012] 1 AC 383 (SC), [103].

7. Similar provision is made for cases of personal insolvency or an IVA under s 372 of the IA, primarily designed to stop utility providers blackmailing the trustee in bankruptcy or supervisor into paying pre-insolvency arrears.

8. (S.I. 2015/989), articles 2 to 4, implementing the Enterprise and Regulatory Reform Act 2013, ss 92 and 93.

9. Again, with a counterpart for IVAs (but not personal insolvency) under s 372A of the IA.

of becoming due (s 233A(3) and (4)). The test for court permission is that continuing the contract *"would cause the supplier hardship"*;

(2) Secondly, the supplier is still allowed to terminate the supply if the administrator or supervisor (upon written request) fails to give a personal guarantee of post-insolvency charges (being given a 14-day period to do so) (s 233A(3) and (5)).

- Significantly, the ban on s 233A clauses does not apply to contracts entered into before 1 October 2015 (when it was introduced).

As a move towards a US-style ban on *ipso facto* clauses, it was rather thin gruel. First, it was restricted to supplies which s 233 had deemed "*essential*", focussing on utilities and electronic supplies. This ignored the fact that there will inevitably be other supplies that are "*essential*", as a matter of fact, to continued operations that do not fall into the s 233 list. Secondly, suppliers were protected by their ability to demand a personal guarantee from the officeholder for post-insolvency charges (failing which the supply can be terminated), or where post-insolvency charges are not paid within 28 days of becoming due (in which case the entire contract can be terminated) – posing a risk to longer term rescue or restructuring strategies, where immediate liquidity is constrained. Thirdly (and most obviously), the limitation to administration and CVAs meant that *ipso facto* clauses were preserved in respect of companies going into liquidation.

New position

Reforms were proposed by the Insolvency Service in 2016, but they were limited. Rather than a blanket prohibition on termination clauses, an expansion of the scope of ss 233 and 233A was proposed – allowing a company in administration or subject to a CVA to designate as 'essential' any of its suppliers, by filing a notice to this effect with the court.

By 2018, however, it was clear from the Government's response to its consultation that more radical reform was on the legislative agenda[10], and the CIGA goes much further than the proposed 2016 reforms.

Section 14 of the CIGA introduces a new s 233B into the IA, titled "*Termination clauses in supply contracts: Protection of supplies of goods and services*" – the ambit of which is far-reaching:

- In the first major departure from s 233A, it applies where a company enters any (existing) insolvency procedure under the IA (thereby including liquidation and provisional liquidation), and also applies where a company becomes subject to the two new procedures introduced by the CIGA: a Part A1 moratorium, and a restructuring plan under (new) Part 26A of the Companies Act 2006. It still does not apply where a company is subject to a scheme of arrangement.
- In the second major departure, it is not restricted to 'essential' goods and services, but applies generally to any contract for the supply of goods or services. It is not as extensive as the US prohibition, which applies to any executory contracts, and not simply those with suppliers.

Next (and using s 233A as the template):

- It contains a blanket prohibition on any (automatic or elective) termination clause continuing to have effect when the company becomes subject to the relevant insolvency procedure (s 233B(3)(a) and (b)). Specifically, one that:

(1) Provides that the contract or supply would terminate, or "*any other thing would take place*", because the company becomes subject to the insolvency procedure; or

(2) Entitles the supplier to terminate the contract or supply, or "*do any other thing*", again because the company becomes subject to the insolvency procedure.

- It also prohibits the supplier from exercising any contractual entitlement to terminate the contract or supply "*because of an event occurring*" before "*the start of the insolvency period*", where the entitlement has arisen before the start of that period (s 233B(4)).
- The 'insolvency period' (for s 233B(4) purposes) is defined by s 233B(8) as beginning when the company becomes subject to the relevant insolvency procedure, and ending at the times identified by reference to each individual procedure.
- The carve-outs to the prohibitions are the giving of officeholder consent, company consent (in the case of a Part A1 moratorium, CVA or Part 26A restructuring plan), or court permission – the latter remaining subject to the test that "*continuation of the contract would cause the supplier hardship*" (s 233B(5)). If any one of these apply, the supplier is entitled to terminate the contract in accordance with its terms[11].

In addition, any supplier is now prohibited from making it a condition of continued (post-insolvency) supply that outstanding charges are paid (s 233B(7)): i.e. the 'ransom' issue which had been addressed by s 233 in relation to essential supplies.

By s 233C, the Government retains powers to amend the new provisions so as to (i) exclude any of the insolvency procedures identified in s 233B(2) (which are currently exhaustive of all possible procedures to which it might apply, save in relation to schemes of arrangement), and (ii) further

10. Department for BEIS, Government Response, 26 August 2018, at 5.97.

11. For completeness (and as with s 233A), where a provision of a contract ceases to have effect under s 233B(3) (i.e. the new prohibitions), and the company becomes subject to a further relevant insolvency procedure, the supplier retains the right to terminate the contract if any of the s 233B(5) carve-outs apply (s 233B(6)).

exclude certain kinds of company, supplier, contract, goods or services from s 233B, or remove any current exclusions (known as a Henry VIII power).

Despite its generality, there are already significant exclusions from the s 233B ban on termination clauses. These are:

- First, exclusions for those essential supplies which already fall within s 233A(1), and continue to be governed by that regime (in administration or a CVA) (Part 1 of Schedule 4ZZA to the IA).
- Secondly, exclusions for (debtor) companies or suppliers who are persons involved in financial services, enumerated in Part 2 of Schedule 4ZZA to the IA (paras 3 to 10) – meaning that the reforms will, for the most part, affect only trade creditors. The excluded entities include insurers, banks, electronic money institutions, investment banks and investment firms, payment institutions, recognised investment exchanges or clearing houses, and securitisation companies. The exclusions also extend to any company or supplier operating outside the UK, if the relevant activities would bring it within the Part 1 exclusions had they been done in the UK (para 11).
- Thirdly, exclusions where the termination clause forms part of a contract involving financial services, including financial contracts, derivatives, spot contracts, capital market arrangements, etc. (all identified in Part 3 of Schedule 4ZZA to the IA), or relates to the financial markets and set-off and netting exclusions which already receive protection in insolvency (Part 4 of Schedule 4ZZA)[12].
- Fourthly, temporary exclusions for small suppliers (defined as a "*small entity*"). These exclusions will stay in effect until 30 September 2020 (s 15 of the CIGA), although indications from the Insolvency Service are that this time-limit is likely to be extended by the Government for a further period up to April 2021. At least two of the default conditions for being categorised as a small entity must be met in relation to the most recent financial year[13], being: (i) turnover not more than £10.2 million; (ii) balance sheet total not more than £5.1 million; and (iii) employees not more than 50 (s 15(4), though there are modifications in relation to suppliers in their first financial year of trading).

What will it mean?

Although the provisions are modelled on the existing s 233A template, there are a number of elements which we expect will give rise to issues (or disputes) between the officeholder or company and its supplier:

- First, the prohibition on '*any other thing*' taking effect if it is triggered by the insolvency (s 233B(3)) is extremely broad, but nevertheless leaves room for dispute as to its ambit. Obvious instances of 'things' caught by s 233B(3) would include altering the terms of the supply, compelling the insolvent party to make higher payments, or switching to payment on delivery. However, there are likely to be a raft of ambiguously drafted clauses in everyday supplier contracts which might (at least arguably) not be triggered by the insolvency procedure. We have in mind, in particular, where something is triggered by events *connected with the insolvency*, but not the company '*becoming subject*' to the procedure itself.

12. Para 21 of Part 4 of Sch 4ZZA also provides that the International Interests in Aircraft Equipment (Cape Town Convention) Regulations 2015 (SI 2015/912) will not be affected by s 233B.

13. Defined by s 15(8) of the CIGA.

	s 233A Insolvency Act 1986	s 233B Insolvency Act 1986	Practical issues
Supplies of essential goods or services	✓	✗	
All supplies of goods or services	✗	✓	• Extremely wide, small suppliers at increased risk in long-term
CVA or administration only	✓	✗	
All insolvency procedures	✗	✓	• Formal insolvency trigger, not actual insolvency – may lead to suppliers terminating pre-insolvency • Puts onus on suppliers to monitor counterparties' financial position, so not left with short time to act • Suppliers may want earlier triggers in new contracts • Suppliers at increased risk where no likely rescue and poor or no liquidity (e.g. liquidation) (subject to payment terms)
Ability to terminate if post-insolvency charges not paid within 28 days	✓	✗ (unless triggers new termination right)	
Ability to terminate if no personal guarantee	✓	✗	• Suppliers (other than essential) do not have this added protection
Ability to terminate with officeholder consent	✓	✓	
Ability to terminate with court permission (hardship test)	✓	✓	• Court approach tbc, and Government guidance suggests strict approach to detriment of suppliers • Unclear if factors relevant to insolvent party (as opposed to supplier) will be taken into account
Extends to termination, or "*any other thing*"	✓	✓	• Will catch wide range of modifications (e.g. concerns where group subject to single supply arrangement) • Potential for dispute with ambiguously-drafted clauses (e.g. where trigger arguably circumstance connected with insolvency)
Extends to termination for any pre-insolvency breach	✓	✓ (if right arises pre-insolvency)	• Potential for dispute as to when right to terminate arises • Especially where continuing breaches, and/or cure period • Extremely wide, will affect e.g. cross-default provision • What about serious breaches? e.g. breach for fraud or wilful default
Applies retrospectively	✗	✓	• Suppliers need to review existing contracts now

- Secondly, it is notable that the ban extends to a contractual right to terminate because of any event occurring before the start of the insolvency period (s 233B(4)) or as a result of the company becoming subject to the insolvency process (s 233B(3)). In particular, if the pre-insolvency event gives rise to the contractual right to terminate, it does not matter whether or not the event is insolvency-related, as long as it occurred, and the entitlement to terminate was exercisable, before the start of the insolvency period (s 233B(4)). This might be thought to catch all relevant defaults. For example, not all non-payment is caused by insolvency but it will still be caught. Similarly, many breaches or events which give rise to an entitlement to terminate will be unconnected with the company's insolvency (e.g. cross-default triggered by insolvency of a group company), but they will still be caught. Certain of these breaches may be serious, such as breach for fraud or wilful default.

  However, there is nothing in s 233B that prevents termination for breach occurring during the insolvency period, as long as that breach is not merely the fact that the company has become subject to the relevant insolvency procedure. As a result, a supplier wishing to terminate might argue that a particular event occurred post-insolvency, or that the entitlement to terminate arose post-insolvency, and thereby take advantage of this limitation. In particular, disputes can be anticipated where a breach is a continuing breach (rather than a fresh, post-insolvency occurrence), or where a contractual term is ambiguous as to when the entitlement to terminate arises. In relation to breaches where there is a notice period, and/or a cure period, suppliers may also find the entitlement to terminate arises post-insolvency. Is such an event something that gives rise to an "*entitlement*" before the start of the insolvency process (the original breach), or does the "*entitlement*" only occur for the first time after insolvency (the failure to cure)?

- Thirdly, given the generality of the 'hardship' test which the court will apply in assessing whether to permit withdrawal of supply (s 233B(5)(c)), it is inevitable that there will be a developing body of case law on the principles to be applied in granting permission. Most obviously, the court will need to assess the economic position of the supplier. The fact that the test is formulated by reference to the supplier suggests that the court will not take into account matters relating solely to the position of the insolvent company: e.g. the viability of its business, or whether the supply is truly critical to the ongoing operations of the company.

- Fourthly, s 233B is silent as to whether it will have extra-territorial effect. This has also been the case for ss 233 and 233A, though it has been held (at first instance) that there was a serious issue to be tried as to whether a s 233 request (for continued supply of essential services) could be made to an overseas supplier[14].

- Finally, despite its breadth of application to contracts for the "*supply of goods or services*", it is possible that questions will arise as to whether a particular contract falls within the ambit of that definition. It seems unlikely, given the familiarity with which such terms are used in contract law, but cannot be ruled-out.

Additionally, there are a number of practical matters to which suppliers will now have to give consideration:

- First, suppliers will need to be particularly vigilant in monitoring the financial position of counterparties, and act swiftly in decision-making if formal insolvency is in prospect. Suppliers may have a short opportunity to act when preliminary steps for certain procedures have occurred, being notice of a meeting to consider a CVA, filing a notice of intention to appoint an administrator, or the presentation of a winding-up petition. The opportunity will be much reduced, however, in the case of a Part A1 moratorium, which is commenced by the directors filing the relevant documents with the court (with creditors subsequently notified) – potentially increasing the incentives for use of this procedure where supplies are critical to the debtor's rescue.

- Secondly, what is especially significant (from a supplier perspective) is that the ban is triggered by formal insolvency, rather than actual insolvency. A termination clause based simply on the company's inability to pay its debts (cash flow or balance sheet insolvent) remains exercisable before the company enters a formal insolvency process. Suppliers may seek to negotiate the variation of existing clauses, or new contracts, by reference to an earlier termination trigger (i.e. a state of insolvency falling short of a formal procedure) – notwithstanding the scope for dispute (as to insolvency) to which this might give rise, and the limited timeframe which a supplier might have to exercise its termination right. Perversely, it might also encourage nervous suppliers to exercise termination clauses at the first sign of a company's distress, accelerating the company's descent into insolvency (which would evidently undermine its rescue objective).

- Thirdly, and related to this, it is possible to conceive of contractual termination clauses which are triggered by events which will occur around the time of insolvency, but are not the entry into the insolvency procedure

14. *Official Receiver v Sahaviriya Steel Industries UK Ltd* [2016] BCC 456 (HHJ Pelling QC).

itself: e.g., for a retail business, a cessation of the company's trading (whether temporary or permanent), or the closing of some or all of its retail stores. If the cessation of trading occurred the evening before the company entered into the formal insolvency process, such as (for example) the appointment of an administrator, should it be viewed as part of the company 'becoming subject' to the insolvency process, or (which seems the better view) as a separate and independent event? And if such events would constitute a repudiatory breach of contract, then it may be that a supplier seeking to terminate the contract will, in any event, be able to fall back onto its common law rights (although that is, of course, not as clear-cut as exercising a straightforward right of contractual termination).

- Fourthly, given that the reforms apply to all existing contracts (even, retrospectively, to those predating their coming into force), suppliers will need to review their commercial contracts on an urgent basis.

In the cross-border context, the reform ought to expand the additional relief which an English court is able to grant under article 21(1)(g) of the Cross-Border Insolvency Regulations 2006[15] (CBIR). More particularly, in cases where recognition is sought of a foreign proceeding taking place in a jurisdiction which prohibits *ipso facto* clauses, and the foreign officeholder seeks to obtain equivalent relief in England (under English law), the courts will now be able to grant this relief (at least to the extent that it is consistent with the prohibition in s 233B). That is a result which was not hitherto permitted - see the *Pan Ocean* decision of 2014[16].

Why now?

It is unsurprising that the *ipso facto* debate has gained traction in recent years, given the existence of prohibitions in other common law jurisdictions, the EU Restructuring and Insolvency Directive, and the increasing desire (fuelled in part by the CBIR) to ensure that the UK is seen as a debtor-friendly jurisdiction. With US Chapter 11 proceedings often cited as a gold standard for restructuring procedures, the *ipso facto* extension was perhaps to be expected in the context of the CIGA reforms which, as a whole, seek to extend the UK's rescue culture to equal prominence.

Having said that, parcelling the reform into fast-tracked legislation to address the COVID-19 pandemic, has inevitably restricted the legislative scrutiny which such far-reaching reform would otherwise have attracted. Given that practitioners have been debating these issues for some time, a mature understanding of them by MPs who scrutinised the Bill seems unlikely in the short time which they had. For example, during the Bill's second reading in the House of Commons on 3 June, an amendment was tabled by a Liberal Democrat MP for these measures to be temporary, precisely to "*allow their effect to be properly analysed*" – and voicing a particular concern that the reform would lead to (unacceptable) risk-shifting that:

"*transfers the risk from the struggling company to the supplier, which, whether in an economic crisis or not, is unacceptable. ... Suppliers should retain the right to choose to withdraw their services if they perceive that their resources will face a lower risk return elsewhere.*

... I accept that there is a balance to be struck between the needs of customers and suppliers, and that during these difficult times supply chains are critical and need

15. SI 2006/1030.

16. *Fibria Celulose S/A v Pan Ocean Ltd* [2014] Bus LR 1041 (Morgan J) (Korean law prohibition on *ipso facto* clause).

17. Hansard, HC (Second reading), 3 June 2020, Col 969 to 970 (Sarah Olney MP).

18. House of Commons Library Briefing Paper, No 8922, 1 June 2020, p 30; following Department for BEIS, Government Response, 26 August 2018, at 5.108 and 5.109.

19. *Ibid.*

to be supported, but we need to take time to consider the long-term risks of introducing such a change to our insolvency procedures, and the introduction of emergency legislation is not that time" [17].

Such concerns seem unlikely to have had time for proper scrutiny. We ask, for example, to what extent can these reforms really be justified by both principle and policy? As a matter of principle, the statutory balance is now to come down in favour of the incursion into the principle of contractual freedom. For prospective contracts, this is easier to accept –the legitimate expectations of parties as to the meaning of their contract will be informed by the current law (including the CIGA). But what about pre-existing contracts? How can contracting parties really be said to have had their legitimate expectations met by a retrospective change in the law such as this?

Does it go too far (or not far enough)?

Does this matter, and is the inroad into the freedom of contract really that substantial? The answer can only be yes. It is true that the new law does not apply to all executory contracts, only to supplier contracts: but that will cover a lot of executory contracts. Moreover, the only protection offered to suppliers by the carve-out is that of seeking court permission to withdraw supply (the hardship test). The Government seems to view this as a "*safeguard of last resort*", stating that:

"the threshold would be high; a supplier would only be able to seek an exemption from the court if continued supply threatens its own insolvency".

Further, in considering the hardship application, the Government has suggested that the court must assess:

"whether the supplier would be more likely than not to enter an insolvency procedure as a result of being compelled to continue supply; and[18]

whether exempting the supplier from the obligation to supply would be reasonable in the circumstances having regard to the effect of non-supply on the debtor company and the prospects of rescue" [19].

Of course, the legislation affords the courts a discretion, and these statements are just what the Government has said. Whether this restrictive approach is borne out by the courts' approach to their discretion remains to be seen. It may be that the "hardship" safeguard will put the court in the position of balancing competing commercial considerations, a role which is usually reserved to the officeholder. Will a court really take on that role?

And even in cases where the courts are willing to lift the *ipso facto* ban, the new law places a significant burden on the supplier (apparently, at its own risk as to costs) to commence court proceedings in short order and to provide evidence of the economic effect of continued supply on its own financial position. In particular, the supplier's concerns are most likely to relate to the risks of non-payment – over which the supplier will have no or little visibility when making the permission application (and which the Government guidance suggests may in any event be irrelevant to the court's assessment unless it would give rise to the supplier's own insolvency).

Even accepting that the statutory balance has come down against freedom of contract, there is a further balance to be struck between the suppliers, on the one hand, and the creditors of the company as a whole. Viewed from this angle, it is more difficult to decide whether this is, in fact, principled reform, and whether it is desirable in policy terms.

The Explanatory Notes expressly identify the protection of supplies as one of the measures designed to achieve the overarching objective of the CIGA (para 2), the objective itself being solely framed in terms of supporting businesses, for continued trading, "*during this period of economic uncertainty*" (para 1). In other words, the purpose is to ensure that distressed businesses remain operational and maximising the chances of rescue. When dealing specifically with the *ipso facto* reforms, it is said (at para 32):

"The policy intention is to help companies trade through a restructuring or insolvency procedure, maximising the opportunities for rescue of the company or the sale of its business as a going concern. The measures will complement the policy for a new moratorium and restructuring plan procedure, which are aimed at enhancing the rescue opportunities for financially distressed companies".

There are problems with this as a general policy objective. The fact that the prohibition will apply in relation to all insolvency processes – including liquidation – raises serious questions over whether the stated rescue objective can, in truth, be said to underpin the reform. At one end of the spectrum, there will cases of 'light touch' administration, CVAs, or the new Part A1 moratorium, where the aim is complete rescue (or eventual sale as a going concern). In these cases, the role played by the *ipso facto* ban in ensuring that the company remains operational is clear, in the interests of the company's survival and of creditors as a whole. By contrast, in cases of liquidation or of a distributing administration, where there is no rescue objective or where risk to the supplier is high, the stated policy foundations for the reforms appear shaky.

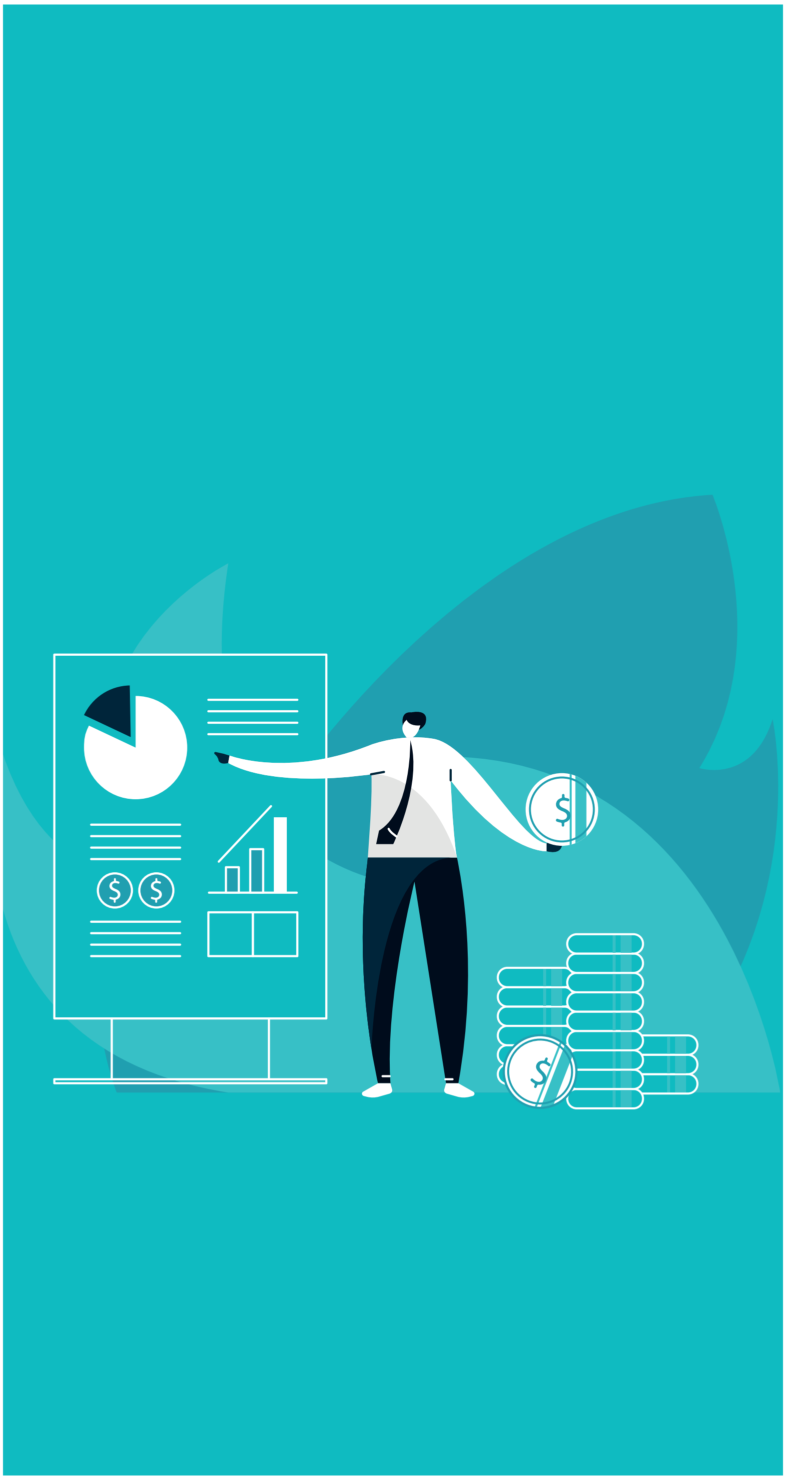
It also seems likely that the policy objective will be raised when hardship applications make their way to the courts. Despite the fact that the court's power to permit supply withdrawal is focussed on the position of the supplier (hardship test), it seems inevitable that suppliers will seek to persuade the court to take the question of whether a rescue rationale exists into account

20. Memorandum from the Department for BEIS to the Delegated Powers and Regulatory Reform Committee, 20 May 2020, pp 31 and 32.

21. Department for BEIS, Government Response, 26 August 2018, at 5.92.

22. If regarded as a complex *bona fide* commercial situation, within the meaning of the *Belmont* decision.

on a permission application. More particularly, it will likely be contended that the supplier risk is not justified when it cannot be said that a rescue, or preservation of the business for purposes of a sale, is likely. It may also be that the Government is cognisant of this: notably, the Henry VIII power (under s 233C) to exclude any of the relevant insolvency procedures (though the justification for this power is not adequately described, focussing instead on the potential damage to trade in particular areas of business or supply[20]).



In policy terms, the reforms can readily be seen as desirable on a temporary footing (as a pandemic response). By contrast, making these changes permanent is less capable of policy justification, at the very least in cases where the likelihood of rescue is open to debate. The extent to which the supplier bears an ongoing risk (in insolvency) is likely to depend on a range of differing circumstances, depending on factors relating to the particular insolvency process involved and the financial position of the distressed company, as well as on factors relating to the terms of the supply contract itself (i.e. duration of payment terms). In particular, as the responses to the Government's consultation process highlighted, the length of certain normal commercial payment terms (90 or 120 days) is a long period of time during a restructuring[21]. Further, in CVAs or Part 26A cases, the supplier will be subject to the payment terms which form part of the restructuring plan (as opposed to being an expense in cases of administration and liquidation, or a payment which must be made under the Part A1 moratorium). This will to some extent be mitigated if there is a contractual right to terminate for non-payment of supplies post-insolvency, but the supplier's unpaid debt will nevertheless have increased.

Subjecting the supplier to this risk might be said to be justified, because value preservation (or maximisation), or the future viability of the business, is in the interests of the company's creditors as a whole. But, of course, this can equally be said to give rise to unfairness as between different creditors of a company (non-supplier creditors not facing the risk of ongoing debts). This is a situation which could be viewed as an anathema to the principles of insolvency law, most obviously manifest in the *pari passu* rule of distribution, and also underpinning the avoidance powers in relation to preferences (under s 239 of the IA). Viewed through the lens of intra-creditor unfairness (as to risk), it is less easy, on policy grounds, to justify its desirability.

To conclude, the *ipso facto* reforms undoubtedly mark a dramatic departure from the long-held principle of contractual freedom (particularly as regards pre-existing contracts). The balance has now come down firmly in favour of promoting rescue and rehabilitation of business. It seems likely that the courts will be asked to revisit the existing common law on the anti-deprivation principle, where particular clauses effect a contractual alteration on insolvency ('any other thing'), which might previously have been saved by the courts' more generous approach in past cases[22]. This is no timid extension of existing law. Whether it is right is another question altogether. ■