

Knowledge

Greater protection to essential supplies of insolvent businesses

OLSWANG



Briefing note on the Insolvency (Protection of Essential Supplies) Order 2015

Summary

The Insolvency (Protection of Essential Supplies) Order 2015 (the "**Order**") came into effect on 1 October 2015 and applies to supply contracts entered into on or after that date.

The Order amends the Insolvency Act 1986 (the "**1986 Act**") to give greater protection to certain essential supplies to insolvent businesses. This briefing note deals with the Order's impact on corporate insolvency¹.

The 1986 Act previously prohibited a supplier of basic utilities (gas, electricity, water and communication services²) from compelling an insolvent company to pay charges incurred before the commencement of insolvency by threatening to cut off supplies unless those outstanding charges are paid. It entitled the utility supplier to make it a condition of the continued supply that the office holder provided a personal guarantee for the payment of any charges in respect of the supply during the insolvency. The provisions were confined to statutory undertakers and similar bodies (i.e. private utility suppliers were not affected).

The key changes introduced by the Order are:

- the scope of protection has been extended to various IT supplies and to private suppliers of basic utilities;
- new provisions have been introduced which provide that an "insolvency related term" of a contract for the supply of essential goods or services ceases to have effect if the company enters into administration or a voluntary arrangement takes effect (thereby preventing a supplier from terminating the supply or supply contract, altering the terms of the contract or compelling higher payments for the supply in such circumstances); and
- safeguards have been granted to suppliers to enable them to terminate the supply or supply contract if they can satisfy certain conditions.

Suppliers under contracts which might be caught within the scope of the Order should seek advice about how they can structure and draft future contracts. They should also seek early advice if their customer faces financial difficulties. The scope of the Order is broad and suppliers might be able to take action to protect themselves.

¹ Similar amendments are introduced for personal bankruptcy.

² Section 233(5)(d) provides that "communication services" do not include electronic communication services to the extent that they are used to broadcast or otherwise transmit programme services (within the meaning of the Communications Act 2003).

1. Extension of protected supplies

The existing list of protected essential supplies ("**PES**") has been widened to include the supply of certain listed goods and services by a person who carries on a business which includes giving such supplies, where the supply is *"for the purpose of enabling or facilitating anything to be done by electronic means"* ("**IT supplies**"). This acknowledges the fact that nowadays IT supplies are as essential to many businesses as basic utilities. The Order lists these IT supplies as: (1) the supply of point of sale terminals, (2) computer hardware and software, (3) information, advice and technical assistance in connection with the use of IT, (4) data storage and processing and (5) website hosting. This adds to the list of PES to which the protections already applied by virtue of being communications services. Card payment service providers that allow payment by electronic means (i.e. Merchant Acquirers) are not included.

The scope of this amendment is very wide, reflecting the policy justification for the Order, namely to promote a rescue culture and business continuity. Exactly how wide it is may be open to debate and disputes about this on this may be expected.

The existing legislation has also been extended to affect a wider list of **private** suppliers of gas, electricity, water and communication services, including the supply of utilities from landlord to tenant.³

The provisions only apply to those who supply businesses directly with the utility or IT⁴. If a business supplies a service which is itself dependent on IT services supplied to it, this legislation will not prevent the indirect supplier terminating the supply.

2. Insolvency Related Terms

The most significant effect of the order is that it renders standard contractual protections ineffective.

- It is not uncommon for a supply contract to provide that certain things will occur if a party becomes subject to an insolvency process. The contract may, for example, provide that the supply contract is automatically terminated or varied or that the supplier is entitled to terminate the contract or vary the supply terms on an insolvency event (for example, charge higher fees). The Order inserts new provisions into the 1986 Act under which "insolvency related terms" which are in a PES contract will cease to have effect where the

insolvent party enters into administration or a company voluntary arrangement ("CVA") takes effect.

- "Insolvency related term" is defined widely as a provision of a contract of supply under which the contract or supply terminates or any other thing takes place or the supplier would be entitled to terminate or do any other thing because of the administration or voluntary arrangement.
- It also extends the definition to any provision in a PES contract that entitles the supplier to terminate the contract or supply because of "an event that occurred **before** the company enters into administration or the voluntary arrangement takes effect". There are no limits on what type of event this provision is designed to capture. It is not only events related to administration or CVA, such as procedural steps taken with a view to administration and CVA. It has the effect of prohibiting termination (or any other thing) due to an event arising under the contract, if the contract has not been terminated (or the other thing has not happened) before the administration or CVA.
- If the contract relates to the supply of a PES and also a non – protected supply of goods or services, the restriction on termination may apply to the whole contract. If the clause which is thereby avoided affects only the supply of PES, this may be capable of severing from the clauses dealing with non- protected services.
- Suppliers would be well advised to seek early advice about structuring new contracts and whether it may be advantageous to act quickly, if customers face financial difficulties.

3. Safeguards

Some safeguards for suppliers of PES have been built in:

- "Insolvency related terms" will continue to have effect to the extent that they apply where a party becomes subject to an insolvency process other than administration or CVA, such as liquidation or receivership. This reflects the fact that those processes do not have as their objective the rescue of the company as a going concern. The existing legislation will however continue to operate in respect of these other processes so that, for example, a supplier will be prohibited from compelling a company in liquidation to pay charges incurred before the start of the liquidation by threatening to cut off supply.

³ For further details, please refer to our separate briefing note.

⁴ Refer to Explanatory Memorandum paragraph 8.3.

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- A supplier will continue to be entitled to terminate the PES contract or supply because of an event that occurs or may occur **after** the company enters administration or the voluntary arrangement takes effect. Suppliers may consider reviewing termination events to make it clear that they apply to post administration or CVA events (for example, a pre pack sale of the business).
 - A supplier will be entitled to terminate the PES contract if the office holder consents or the court grants its permission, or if any charges incurred after the company entered into administration or the CVA took effect are not paid within **28 days** beginning on the day on which payment is due. In determining whether to give consent, the office holder should consider whether the continuing operation of the contract is necessary to achieve a better realisation for the creditors as a whole.
- However, the court can grant permission if it is satisfied that the continuation of the contract would cause the supplier hardship. It is not clear what factors will be taken into account by the court in making this determination.
- A supplier will also be entitled to terminate the supply if it gives written notice to the office holder that the supply will be terminated unless the office holder personally guarantees the payment of any charges in respect of the supply during the insolvency and the office holder does not give that guarantee within **14 days** beginning on the day the notice is received. There is no requirement on the office holder to elect to adopt the contract or to pay pre-appointment fees. Nevertheless, it can be expected that insolvency practitioners will find the provision of such a guarantee uncomfortable, at least without a valuable indemnity.

Conclusion

The Order recognises that IT supplies are as essential to modern day businesses as basic utilities. Including these within the scope of the existing protections in the 1986 Act is likely to be welcomed by IT dependent businesses, administrators and CVA supervisors.

The most controversial aspect of the Order is that it overrides a supplier's right to choose to terminate or vary the terms of a PES contract where an administration or CVA process takes effect. Safeguards have been introduced to protect a supplier's right to terminate the PES contract or the supply, but they are limited. The supplier has to take proactive steps and wait for statutory time limits to pass. This delay could be significant in some cases.

Suppliers would therefore be well advised to seek advice about existing contracts and the structuring of new contracts. They should also obtain advice in the early stages if a counter party is in breach of a contract for the supply of PES or might be approaching insolvency.

Please note that this briefing note is only a summary of relevant issues and is not a substitute for legal advice and cannot be relied on as such. Advice should be sought on specific matters addressed in this note.

Profile



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Alicia Videon

Alicia specialises in restructuring, insolvency, distressed investment and non-performing loan sales.

She has significant experience representing lenders and syndicates, as well as other stakeholders, involved in local and multi-jurisdictional work-out assignments. She is known for providing responsive and commercial input on strategic issues.

Her recent focus has been on commercial real estate, leisure and cmbs deals. Alicia has advised on a number of recent high profile distressed real estate transactions representing specialists in property finance.

Alicia also advises buyers and sellers of distressed debt, assisting in negotiating and documenting trades and implementing trading and investment strategies.

Chambers & Partners 2014: Alicia Videon "is incredibly responsive, responds quickly and always finds solutions to problems, even when the answers are not obvious."

Chambers & Partners 2013: Alicia Videon "thinks outside the box, and is very commercially minded and interactive".

Chambers & Partners 2012: Alicia Videon strikes "the right balance between subtlety and aggression".



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Julian specialises in insolvency and restructuring matters and advises banks, insolvency practitioners and other stakeholders on a broad range of issues, often with a cross border element, as well as providing structuring advice on complex finance transactions.

Julian also has financial services and banking experience and has acted on a number of companies act schemes of arrangement. Julian has undertaken transactions in a number of industry sectors including media, technology, financial services and insurance, real estate and leisure.

Julian has significant Middle East experience having spent three years in Abu Dhabi.



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Emma specialises in restructuring and insolvency.

She acts for senior and mezzanine lenders, special servicers, office holders, private equity funds and others in the workout arena, with an emphasis on the real estate, retail and leisure sectors.

Emma joined Olswang in 2010. In 2011, she was on secondment to the Lending & Corporate Finance team at the National Asset Management Agency in Dublin



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Caroline acts for a wide range of domestic and international lenders, borrowers and office holders.

She primarily advises on formal insolvency processes and new money and debt restructuring finance transactions.

Caroline works in a variety of sectors, with a focus on private equity, real estate, retail and leisure.

Having read History at Cambridge Caroline chose to convert to law. She trained and worked at a leading City law firm before joining Olswang in early 2014.

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