

# The Corporate Insolvency and Governance Act 2020 and the Oil & Gas Industry

# Introduction

The Corporate Insolvency and Governance Bill was published on 20 May 2020 and went through an accelerated parliamentary process, receiving Royal Assent on 25 June 2020 (with the provisions coming into force on 26 June 2020).

The Corporate Insolvency and Governance Act 2020 (“**CIGA**”) introduces a mixture of permanent and temporary “debtor friendly” measures to restructuring and insolvency law in England and Wales and in Scotland, jurisdictions which have historically been viewed as being “creditor friendly”.

Although a key immediate objective of CIGA was to provide businesses with the flexibility and breathing space required to continue trading during the financial strain caused by the Covid-19 crisis, CIGA also introduces new permanent restructuring procedures, which give the directors of a company the opportunity to restructure the business with the benefit of a moratorium, which pauses creditor and counterparty enforcement rights. Within the context of the North Sea oil & gas industry, CIGA has the potential to impact upon relations with the supply chain, and within joint ventures.

# Changes introduced by CIGA

## Prohibition on Termination of Contracts “by reason of” insolvency

CIGA introduces restrictions on termination rights by incorporating new provisions into the Insolvency Act 1986.

A supplier of goods or services may not, where a recipient counterparty enters an insolvency process, terminate the supply contract (or do any other thing) by reason of:

- a provision permitting termination due to the insolvency of the counterparty, or
- a termination event occurring before the counterparty’s insolvency where that right had not been exercised prior to the insolvency.

These provisions also apply in relation to the new additional insolvency arrangements introduced by CIGA so would also apply where a party to the relevant contract enters into a new Restructuring Plan or moratorium procedure as introduced by sections 1-6 of CIGA.

The new provisions apply to:

- all suppliers of goods or services (with some exceptions in relation to financial services and insurance companies),
- all existing and future contracts for the supply of goods or services, and
- notwithstanding any agreement between the supplier and the customer to the contrary; there is no contracting-out option.

Although impeding parties’ freedom of contract, which is an important principle of English law, the intention of these new restrictions is to ensure maximum opportunity for rescue of a business as a going concern by maintaining supply. Provisions have been put in place to stop the past problem of insolvent debtors being held to ransom by threats of termination. The effect of the new provisions is that the supplier is obliged to continue to supply during the insolvency or restructuring process and is not guaranteed payment of outstanding arrears, although this would not impact on contracting for any new services.

## New Restructuring Plan and Associated Moratorium

### *New Restructuring Plan*

Prior to CIGA there were two procedures under English law for voluntary compromise with creditors – a company voluntary arrangement and the scheme of arrangement under Part 26 Companies Act 2006. CIGA introduces a new restructuring process which enables directors to propose a “Restructuring Plan” to compromise the claims of creditors and/or members. A key feature of the new provisions is the “cross-class cram down”, which is not possible under a scheme of arrangement. This feature allows the court to sanction the approval of a compromise or arrangement where dissenting classes of creditors and/or members are bound on certain conditions and may prevent a class of creditors holding only a small proportion of the company’s debt from vetoing the compromise.

The Restructuring Plan route is only available to companies which have or are likely to encounter financial difficulties that affect their ability to continue to trade as a going concern, and that propose a compromise or arrangement between the company and its creditors and/or members.

## The process

The process involves a two-stage court approval:

- The first application to court is for an order that meetings of creditors and/or members should be convened to consider the proposed Restructuring Plan. During the meeting creditors and/or members will be asked to approve the Restructuring Plan, and 75% is required for approval. The key novel feature is that a Restructuring Plan can be imposed on creditors without each class necessarily voting in favour of it, provided that at least one class does approve the plan. One class alone can approve the Restructuring Plan on the basis that such class would either (i) receive a payment or, (ii) have a genuine economic interest in the company in the event that the Restructuring Plan was not approved and the most likely alternative arrangement were to occur. A court can exclude a class of creditors from voting if they do not have a genuine economic interest in the company.
- The court will then be asked to approve the Restructuring Plan, even if not all classes have approved (the “cross-class cram down” feature).

The Restructuring Plan allows a compromise or arrangement between the company and its creditors, or any class of them, and the purpose is to eliminate, reduce or mitigate the effect of the company’s financial difficulties. The kind of compromise is flexible.

## *Moratorium*

CIGA also introduced a new standalone moratorium procedure which leaves directors in control whilst they implement a plan to rescue the company. During the moratorium period, the company will be provided with breathing space and creditors must refrain from enforcement action against the company. This includes petitioning for the winding up of a company, submitting an application for administration or providing notice of intention to appoint an administrator.

Directors can apply for a moratorium for an initial period of 20 business days, but this can be extended for a further 20 business days (both with or without the consent of creditors). During this period, whilst the directors do remain in control, a licensed insolvency practitioner is also appointed to monitor the company’s affairs to keep under review whether it is likely that the moratorium will result in the rescue of the company as a going concern.

## Eligibility and obtaining a moratorium

- No applications can be made if the company has entered into a moratorium in the previous 12 months without the order of a court.
- Some companies are not eligible, such as insurance companies or banks.
- The company must be, or likely to become, unable to pay its debts.

Directors of an eligible company can obtain a moratorium by filing the relevant documents with the court, which includes a statement from the director that the company is or is likely to become unable to pay its debts.

It is possible for directors to apply for a moratorium whilst negotiating the Restructuring Plan described above. Exit from a moratorium could be the recovery of the company without need for an insolvency process, or it could be a precursor to an insolvency process.

A company may still borrow and incur credit during a moratorium, provided it discloses there is a moratorium, and it may still grant security over property if the appointed insolvency practitioner consents.

# Impact on the Oil and Gas Industry – Key Agreements

## Operating Agreements

### *Prohibition on Termination of Contracts “by reason of” insolvency*

With regards to the Oil & Gas UK (“**OGUK**”) standard Joint Operating Agreement (“**JOA**”), the purpose of the agreement is to define the parties’ *“respective rights, interests, duties and obligations in connection with the Licence and in connection with all Petroleum produced under the Licence”*. The Operator acts as agent for its fellow licensees and is not paid for the provision of a service. It is therefore less likely that the restriction on termination or withholding of supply or goods would apply.

### *New Restructuring Plan and Associated Moratorium*

## Forfeiture

Those familiar with the oil & gas industry will be aware that model form JOAs, such as those published by OGUK in 2009 or the Association of International Petroleum Negotiations (“**AIPN**”) in 2012 contain forfeiture provisions in event of a Participant’s default. Typically, if default is not remedied within a fixed-period (normally 45 – 120 days) the non-defaulting Participants have the right to acquire the defaulting Participant’s interest for either nil or a discounted consideration.

The statutory moratorium in the event of administration contained in the Insolvency Act 1986 does not prevent forfeiture of contracts. Many of the effects of the new CIGA moratorium are similar to that of an administration moratorium – security cannot be enforced without leave of the court, legal proceedings cannot be commenced or continued, and floating charges cannot crystallise. It is therefore possible that, as with administration moratoria, forfeiture or termination rights may continue to be exercised during the CIGA moratorium. However, the relevant provisions of CIGA (sections 1 through 3) do not expressly say so.

(Whether JOA forfeiture provisions triggered during an insolvency process fly in the face of the anti-deprivation rules under English insolvency law is a matter of debate beyond the scope of this note, although as the scope of what amounts to insolvency has been widened under CIGA, this may once again be raised within case law and subject to further clarification in future. We discussed this in our article “Default Clauses in Joint Operating Agreements: Recent Guidance from the English Courts”.<sup>1</sup>)

## Default

Typically, insolvency is not in itself a default event under the JOA, and default in the context of a JOA is limited to the failure of a party to pay an invoice or cash call by the due date. The default process is triggered by service of a default notice by the Operator. If the Operator is in default, however, then normally the non-defaulting participant with the most equity under the JOA can exercise default rights on behalf of the non-defaulting Participants. Any default of an Operator for reasons of insolvency may also trigger a breach of the Licence, pursuant to which the JOA is put in place.

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<sup>1</sup> Judith Aldersey-Williams and others, ‘Default clauses in joint operating agreements: recent guidance from the English courts’ [2016] International Energy Law Review 2, 36.

JV management is an important part of any UKCS operation; however, the following points should be considered with additional scrutiny:

- **Engage with counterparties early/maintain close and regular contact.** Interaction of financial distress with JOA default provisions and the positions of various stakeholders in insolvency default scenarios is key.
- **Check your co-venturers' solvency.** Do not assume that the other party to any agreement is solvent.
- **In the current economic climate, there is a heightened risk that co-venturers will develop differing views on appropriate work programmes and budgets for the forthcoming period.** If you are incurring expenditure on behalf of others, ensure that approvals are in place. Companies with financial constraints should consider the risk that a work programme and budget may be setting the company up for a default and result in forfeiture.

## Removal of Operator

If an operator is subject to either of the new measures, it could lead to removal of that party as operator. The OGUK standard JOA provides for the removal of the Operator in certain circumstances. This includes in the event of the Operator becoming insolvent, Clause 5.3.2(f) contains a catch-all provision in relation to insolvency proceedings which is likely to include the new CIGA measures.

## Supply of Services Contracts

### *Prohibition on Termination of Contracts "by reason of" insolvency*

Do all oil and gas related contracts fall to be classified as contracts for the "supply of goods or services"? Regarding supply of services, and using the most basic definition of the term, under s12(1) of the Supply of Goods and Services Act 1982 ("**SGSA**"): "*a contract for the supply of services is a contract under which a person ("the supplier") agrees to carry out a service...*"

Accordingly, a supply of services agreement is a contract that sets out the terms by which services will be provided to a customer by a supplier. All contracts for the supply of services must include an accurate and appropriately detailed description of the services. The agreement should also articulate the standards to which the services must be performed and an express obligation on the supplier to provide the services to the customer.

There is therefore good reason to believe that upstream agreements for the provision of transportation, processing etc. services will be subject to the limitation on termination rights noted above; where there is a clear service provided in accordance with clear tariffs/cost share provisions, quality of products and the like.

## Supply of Goods Contracts

### *Prohibition on Termination of Contracts "by reason of" insolvency*

In a similar vein to supply of services contracts, s2(1) of the Sale of Goods Act 1979 ("**SOGA**") provides as follows: "*a contract for the sale of goods is a contract by which the seller transfers or agrees to transfer the property in goods to the buyer for a money consideration, called the price*". From an oil and gas perspective, product sales agreements would appear to come into consideration here, however, a degree of caution should be exercised in considering whether they are in fact contracts for the sale of goods.

In many circumstances, product sales agreements will not fall within the broad scope of "Goods", as defined by SOGA; they are neither "specific" nor "ascertained". Although this will depend on the terms of the relevant sales contract; the form that any fuel is in and the nature of the supply (and any retention of title) will be relevant considerations.



## Licences

### *New Restructuring Plan and Associated Moratorium*

Insolvency is generally a ground for the OGA to partially revoke a licence. The statutory provisions permitting the Secretary of State for the Department of Business, Energy and Industrial Strategy (via the OGA) to partially revoke a production licence by reason of the company's insolvency is not affected by the moratorium. As presently drafted, the model clauses allow partial revocation in the event of bankruptcy or sequestration, arrangement or composition being made with creditors, the appointment of a receiver or administrator, or any liquidation. The new Restructuring Plan is an arrangement with creditors which could fall within the scope of the model clauses meaning that it could result in partial revocation of a licence. However, partial revocation on the basis of the new moratorium introduced by CIGA, would require the model clauses to be amended to apply also in relation to this.

## Decommissioning Security Agreements

### *New Restructuring Plan and Associated Moratorium*

Insolvency of a Participant or issuer of security is a default event prescribed under the OGUK industry standard Decommissioning Security Agreement ("**DSA**"). The OGUK industry standard DSA provides that a Licensee or Qualifying Surety is insolvent if an event occurs or proceedings are raised which have similar effect to the insolvency proceedings listed in the definition. This is likely to include the new CIGA measures. If the CIGA measures are captured by the insolvency procedures in the DSA, either by amendment or through this catch-all provision, this means there are now more circumstances in which the default process could be triggered.

It is also worth considering the relationship between the JOA and any DSA in place. In using the industry standard templates, a JOA default for failure to pay will also likely be a cross-default under any DSA if the invoice relates to decommissioning expenditure, and failure to post security under the DSA may well be a default event under the JOA. If the DSA includes the new CIGA measures and a Participant initiates a moratorium or proposes a Restructuring Plan, this could give rise to default under the DSA and cross-default under a JOA. It is possible that a party may be insolvent and thus in default under the DSA, and thus in cross-default under the JOA, even if it has paid all of its invoices under the JOA and even if the trigger date has not been reached and it has no obligations to provide security under the DSA. This may be an undesirable result in causing considerable uncertainty for the future of the joint venture.

# Protections for the Supply Chain

For a supply chain already managing its way through an oil price crash, CIGA may significantly limit the ability to seek an appropriate remedy for a defaulting counterparty with significant ensuing effects on cash-flow. For that reason, it is prudent that companies consider reviewing and exercising their options at an earlier stage pre-insolvency so that the CIGA restrictions don't bite. However, termination rights may still be exercised in certain circumstances and the impact is only likely to be keenly felt towards the lower-end of the supply chain; there remains four considerations in which unpaid suppliers can initiate their termination rights once an insolvency or formal restructuring process has begun:

- 1. Consent** – if the company/customer or, if applicable, the relevant insolvency practitioner consents to the termination of the supply contract. This consent may be more likely to be forthcoming in the event that the contract is deemed to be 'non-material' to a particular project.
- 2. Small Suppliers Exemption** – at the time of writing, there is a temporary exemption (which currently applies until 30 June 2021) for small suppliers (defined by reference to turnover, balance sheet and/or employee head count) which will continue to be allowed to terminate a contract for the supply of goods or services if the other party has entered into an insolvency process. Although this is unlikely to impact upon the larger companies within the oil & gas supply chain, projects may still be impacted – subcontractors or small component manufacturers may fall within the remit of the exemption.
- 3. The 'hardship' protection** – for suppliers, this provision allows for protection where the Court is persuaded that being required to continue the supply would cause 'hardship' to the supplier's business and grants permission for the contract to be terminated. The scope of 'hardship' is not defined in the legislation and the onus lies with the supplier to demonstrate what the hardship is. This potentially could have a broad meaning beyond strict financial impact to wider impacts within the supply chain. However, the threshold for what is deemed to be hardship is generally considered to be high. The Court of Appeal has considered the general meaning of hardship in the context of gas sales agreements, Donaldson LJ stated that hardship is "weighty or serious" and not "here today and gone tomorrow",<sup>2</sup>
- 4. Overseas Companies** – subject to limited exceptions, CIGA principally only applies to companies registered in Scotland or England and Wales; overseas registered companies (or those with their head office based overseas) will be exempt so existing termination rights will still be exercisable in the event of the insolvency of a company registered elsewhere.

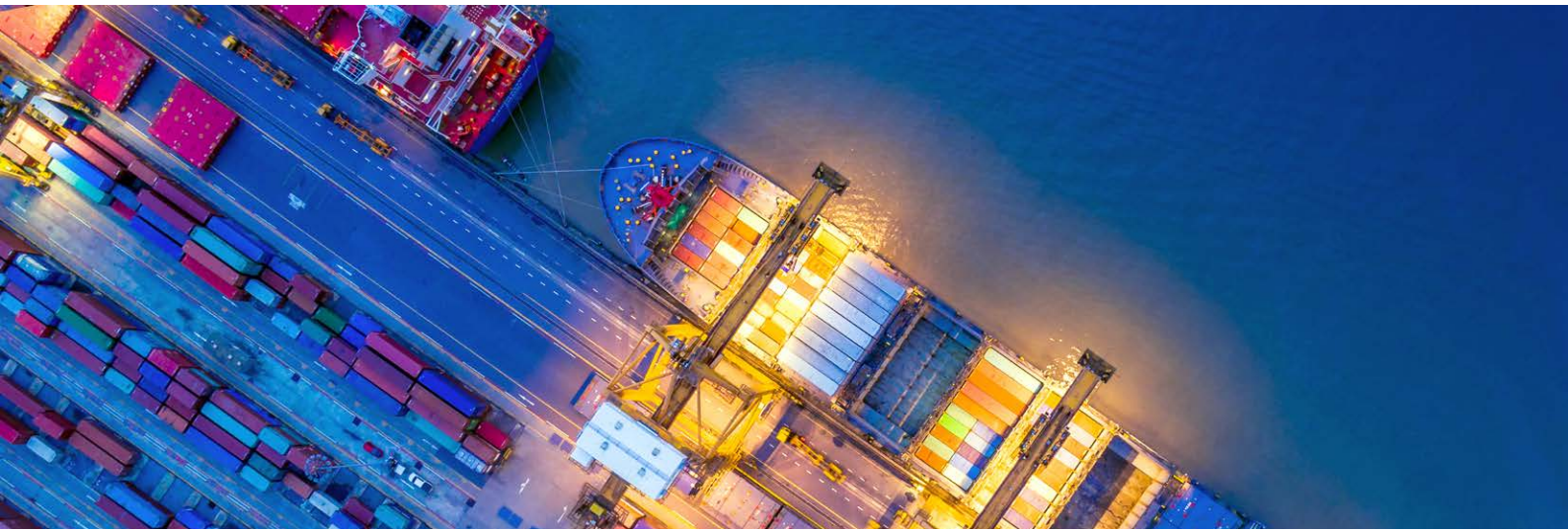
The aim of the new provisions under CIGA is to facilitate the rescue of insolvent customers during the insolvency or restructuring process. However, it is important to understand and anticipate what can be done prior to reaching this point: by way of effective contracting or otherwise.

Typically, industry contracts are more favourable towards the operator or other recipient of the goods or services with regard to termination rights. For example, in LOGIC standard contracts, the contractor (being the supplier of the goods or services) in the absence of special conditions addressing this point has no express contractual rights to terminate, although rights at law may be reserved allowing for termination where this would be permitted under common law.

Termination provisions in supply chain contracts generally allow termination based on the contractor's financial distress only on initiation of formal insolvency proceedings, although often the customer has the right to terminate for convenience; this could still provide early termination rights. Any such rights would not be affected by CIGA as this applies only to insolvency of the customer.

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<sup>2</sup> Superior Overseas Development Corp and British Petroleum (UK) Co v British Gas Corp [1982] 1 Lloyd's Rep. 262, 268



There are a number of commercial and practical considerations that should be thought through when either putting in place a new contract or in managing relations:

- **If you are a supplier of goods or services, check when agreements allow you to terminate or remove a party for insolvency or financial distress.** It is also important to be aware that when a party goes into administration or insolvency, the applicable law may restrict your contractual rights. Ensure that you understand your rights and do not delay acting until it is too late.
- **Consider worst case scenarios during pre-contract negotiations and drafting**
  - have any issues been highlighted by pre-contractual counterparty due diligence?
- **Seek contractual protections tailored to the risks identified in each case.**
- **Be alert – look out for early warning signs:**
  - **Customers/clients:** have they been late in making payments?
  - **Suppliers:** has the supplier requested variations in payment terms or chased overdue payments to ease its cash flow? Are you receiving complaints from sub-contractors that they are not being paid on time?
  - **Ensure your teams know what to do in the event of insolvency.** If you have a protocol, make sure teams understand it; if you do not have one, think about how you could put one in place. Actions in the first few days can be critical to recovery so it is vital that staff are aware of the steps they need to take.

More information on CIGA and associated secondary legislation can be found within the following previously published Law-Now's:

- [Changes to Coronavirus Provisions under the Corporate Insolvency and Governance Act 2020](#)
- [Corporate Insolvency and Governance Act 2020](#)
- [The Corporate Insolvency and Governance Act 2020 and Aircraft Finance – Part 1](#)



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