# The impact of CIGA 2020 on Insolvency on UK Construction Contracts

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## Introduction

The Corporate Insolvency and Governance Act 2020 ("CIGA") came into force on 26 June 2020 after rapid progress through parliament,[1] bringing with it significant reforms to the UK's insolvency framework. The overarching objective of CIGA, at least as set out in the government's explanatory notes, is to provide businesses with "*breathing space*"[2] in order to continue trading in light of the Coronavirus crisis and its potential financial impact on businesses across the UK.

As will be seen below, CIGA has introduced temporary measures (such as preventing the presentation of winding-up petitions) but has also brought about permanent changes implementing a ban on termination clauses. Whilst the temporary measures are of interest, the ban on termination clauses has a bigger impact on the construction industry and standard form contracts such as the JCT and NEC. Whilst, at this stage, it is hard to predict the impact that CIGA will have on the drafting of future contracts, suppliers across the UK may have to change their approach at tender stage.

This article will touch briefly on the prevention of winding-up petitions and statutory demands, before focusing on the ban in respect of exercising the right to terminate a contract due to the insolvency of a party.

## Temporary measures –winding-up petitions

Schedule 10 of CIGA has placed a temporary restriction on the ability to commence winding-up proceedings. It is important to note that – very unusually – this restriction has a retrospective effect and therefore may apply to any attempt to present a winding-up petition based on a statutory demand that was served on a company in the period between 1 March 2020 and 30 September 2020.[3] In addition, creditors are prevented during that period from presenting winding-up petitions based on an unsatisfied statutory demand that was served before 1 March 2020, or a failure to pay a judgment debt during that period unless very narrow requirements are met.[4]

*Does this mean a complete ban on presenting winding-up petitions?*

The short answer is "theoretically, no", but in practice it will affect all statutory demands served since 1 March 2020 and, probably, almost all winding-up petitions that might be presented before 30 September 2020. CIGA clearly sets out that a winding-up petition may not be presented unless there are reasonable grounds for believing that:

1. *Coronavirus has not had a financial effect on the company; or*
2. *The relevant ground would apply even if coronavirus had not had a financial effect on the company.*[5]

1. It was first introduced in the House of Commons on 20 May 2020 and introduced to the House of Lords on 3 June 2020.
2. Corporate Insolvency and Governance Act 2020, Explanatory Notes, chapter 12, page 4 <https://www.legislation.gov.uk/ukpga/2020/12/pdfs/ukpgaen_20200012_en.pdf>
3. Schedule 10, Part 2, Paragraph 1 CIGA 2020.
4. Schedule 10, Part 2, Paragraph 2 CIGA 2020.
5. Schedule 10, Part 2, Paragraph 2(2) CIGA 2020.

In light of a recent decision in the High Court, and as the overriding objective of CIGA is to provide companies with "breathing space", successfully presenting a winding-up petition before 30 September 2020 could be a very difficult challenge. In *Re a Company (Application to restrain advertisement)*,[6] ICC Judge Barber confirmed that proving that coronavirus had a "financial effect" on a company is:

> *"... clearly intended to be a low threshold; the requirement is simply that 'a' financial effect must be shown; it is not a requirement that the pandemic be shown to be the (or even a) cause of the company's insolvency..."*

Whilst the Judge was considering the, then proposed, requirements set out in Schedule 10, Part 2, Paragraph 5(1)(c) CIGA 2020, the reasoning is clearly analogous to the application of the test set out in Part 2, Paragraph 2(2).

It is the stated intention of these temporary provisions to provide companies with "breathing space" in the hope that they can survive and carry on as viable businesses after the worst of the coronavirus crisis has passed. In the construction industry, however, which is highly dependent on cash flow and where companies may be at risk of receiving statutory demands or winding-up petitions as a result, it may be worthwhile being aware of these temporary provisions both for parties at risk of insolvency and for those seeking to have debts paid.

**Ban on exercising termination clauses in insolvency situations**

The provision of CIGA that is likely to have the most wide-ranging consequences is the *permanent* ban on the exercise of termination clauses in contracts for the supply of goods and services through the introduction of a new section 233B of the Insolvency Act 1986 (Article 197B of the Insolvency (Northern Ireland) Order 1989).[7] This is a major change to UK insolvency law and, for the construction industry, could have significant impacts on supply chains where parties are using standard form contracts such as JCT and NEC.

The new provision means that suppliers of goods and services to an insolvent company are no longer able to rely on a contractual right to terminate or to "do any other thing" that arises because the company that it is supplying has become subject to a "relevant insolvency procedure" (defined at 233B(2) IA 1986 to include administration, liquidation and the new moratorium measures). Further:

- the supplier is also prevented from terminating if the right to terminate had arisen before the company entered into the relevant insolvency procedure; and
- a supplier is prohibited from making payment of outstanding charges a condition of any further supply of goods and services when the company becomes insolvent.[8]

It is easy to see that, in a construction context, subcontractors and suppliers will fall within the definition of being "suppliers of goods and services" to companies immediately above them in the supply chain. Unless they fall within the limited scope of exemptions to the ban (see below), they will be forbidden from using their contractual right to terminate (as will be seen below, such rights are usually reciprocal under the

6. [2020] EWHC 1551 (Ch).
7. Section 14 CIGA 2020.
8. Section 14 CIGA 2020.

common standard forms) in the event that the company they are supplying enters into an insolvency procedure. This leaves the subcontractor or supplier in a position where they have to keep working or supplying goods and materials to a company that they know is insolvent. In a cash-tight industry, that will not be an attractive prospect.

Note, however, that CIGA does not prevent a party higher up the supply chain from exercising its contractual right to terminate in the event that one of its suppliers enters insolvency. For example, a main contractor can still rely on a contractual termination clause in relation to its insolvent subcontractor, but if the main contractor becomes insolvent, the subcontractor cannot terminate.

Clearly, this could lead to difficulties for those companies which, whilst small in size, are not small enough to qualify for the "small suppliers" exemption at section 15 of CIGA (namely, companies that meet two of the following: (i) having a turnover of less than £10.2 million, (ii) having a balance sheet total of less than £5.1 million, and/or (iii) having fewer than 50 employees) and might not be able to afford to keep on supplying goods or services without payment.

*JCT contracts*

In the unamended JCT contracts, the Contractor and Employer both have a right to terminate the contract on the basis of insolvency of the other party under Section 8 of the Contract. The provisions below are taken from the JCT 2016 Design and Build Contract, but it should be noted that the relevant clauses are the same in the other 2016 versions and also in the 2011 versions of JCT contracts.

> *"8.5.1 If the Contractor is Insolvent, the Employer may* at any time *by notice to the Contractor terminate the Contractor's employment under this Contract" [emphasis added]*

The above entitles the Employer to terminate the contract from the date upon which the Contractor is "Insolvent" and, for the reasons set out above, it would appear that this provision is still available to the Employer under CIGA. However, care must be had for the gap that CIGA has created in the definition of "Insolvency" in JCT contracts. Section 233B(2) IA 1986, inserted by CIGA, creates a new "moratorium" process and the new procedure in respect of this "moratorium" procedure (and its associated arrangements) is not currently included within the definition of "Insolvency" in the JCT DB 2011 and 2016 contracts. Accordingly, an Employer will not be able to terminate a Contractor who chooses to use the new "moratorium" procedure for being in "Insolvency". It is also worth noting that, as explained above, the presentation of a winding-up petition (which is one of the "Insolvency" triggers under clause 8.1.4 of JCT DB 2011/2016) is almost impossible before 30 September 2020 (and may not be straightforward thereafter).

Turning to the options that are available in the unamended standard form for the Contractor:

> *"8.10.1 If the Employer is Insolvent, the Contractor may by notice to the Employer terminate the Contractor's employment under this Contract."*

For the reasons set out above, it is no longer open to a Contractor to terminate for insolvency, because CIGA has removed this right despite it being part of the agreement between the parties.

*NEC contracts*

In the unamended NEC3 and NEC4 Engineering and Construction Contract, termination provisions are found at Section 9, and under clause 91.1 either party may terminate the contract for insolvency reasons including administration, liquidation, bankruptcy, the appointment of a receiver and a winding-up petition. (Obviously, the NEC contracts do not yet provide for the new "moratorium" procedure as an event of insolvency.) Again, as with the JCT contracts, the new s.233B of the IA 1986 inserted by CIGA results in this provision ceasing to have effect for a supplier.

However, just like the JCT, the Employer retains its right to terminate on insolvency of its Contractor.

*Is it impossible to terminate on insolvency?*

There are a small number of exceptions to the ban on exercising termination on insolvency clauses. These are:

- the exception for small suppliers (see above);
- the insolvent company (or the insolvency office holder) consenting to the termination of the contract; and
- on the application of the supplier, a Court being satisfied that the continuation of the contract would cause the supplier "*hardship*" and therefore allowing the supplier to terminate the contract.

In practice it seems that applying to the Court may be the most common route for suppliers to rely on their termination clauses. However, whilst it is reassuring that the Court might support a supplier terminating for "hardship", there is no definition within the Act, nor any assistance in the guidance, as to what constitutes "hardship". This could be a high bar given that the purpose of the introduction of this provision was to prevent suppliers from terminating contracts on the basis of insolvency. In addition, the supplier will have to incur further expense (legal costs of making an application, preparing accounting evidence and attending a hearing) for the Court to determine whether the supplier will suffer "hardship", which could have the detrimental impact of further worsening the financial position of the supplier.

*Can I still rely on suspension for non-payment?*

In the context of the construction industry, the right to suspend for non-payment by the final date for payment is well established and well known. The right was introduced by s.112 of the Housing Grants, Construction and Regeneration Act 1996 ("**HGCRA**") and is now often expressly included in construction contracts (including the JCT and NEC standard forms). The obvious purpose of this right is to allow a supplier to limit its exposure and conserve its cash flow in the face of a counterparty who has failed to pay in full on time.

There is no obvious reason why this right should be affected by the new provisions in CIGA that prevent a supplier from terminating or doing "any other thing" when a supplier's customer fails to pay. That is because the trigger for the right to suspend under the HGCRA (or the equivalent contractual provision) is the fact of failure to pay in full by the final date for payment – not the fact of the company becoming insolvent (although that may well have caused or contributed to the non-payment). CIGA only applies where the contractual right to terminate (or do anything else) arises by reason of the insolvency itself, so it does not undermine the right of suspension.

This may be of limited comfort, however, to a subcontractor or supplier who is not owed money by the company it is supplying on the date when that company enters insolvency but which then has to carry on working for a month or so (because it cannot terminate the contract) before it can rely upon its right of suspension when the insolvent company fails to pay.

*This is not the end of termination on insolvency clauses!*

It might be thought that there is no longer any purpose in including contractual provisions for termination on insolvency, but that would be wrong. The company being supplied may still want the right to terminate a supplier that becomes insolvent. Further, a company supplying goods (and therefore unable to rely upon contractual termination provisions) will still need such terms within its contract in order to have the option to apply to the Court under the "hardship" provision (even if that option is not taken).

## Conclusion

Whilst the provisions in relation to the enforcement of service of statutory demands and presentation of winding-up petitions are temporary, it is important to be aware of them because of their potential effect on the recovery of debts by way of these well-known mechanisms.

The ban on termination on insolvency clauses is here to stay and has potentially wide-ranging effects on the construction industry. It is presently difficult to predict how this significant change to the law will affect the commercial reality of constructions contracts, but what is clear is that parties will not be able to contract their way out of the effects of CIGA. It is also hard to see how suppliers can protect their position because the ban is drafted so widely.

Suppliers will have to spend more time at tender stage considering payment periods and ensuring stringent credit checks and due diligence are carried out in respect of their customers. In practice, however, depending where a supplier sits within the contractual chain, negotiating better payment terms with its customer may not be an option and therefore as many searches as possible should be carried out in order to provide the supplier with comfort upon entering the contract. In seeking to give insolvent companies "breathing room", CIGA may end up suffocating some suppliers instead.