Proposed amendments to UK insolvency regime could affect termination clauses

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On 26 August 2018, the UK government published its response to a consultation concerning proposed improvements to the UK insolvency regime. As a result, a number of modifications and amendments have been identified.

These proposed amendments include:

a) the introduction of a new standalone restructuring procedure;
b) a new moratorium procedure;
c) prohibitions on suppliers terminating contracts on grounds of insolvency;
d) attacks on value extraction schemes; and
e) greater accountability for directors (both past and present) of distressed companies.

The impetus behind these reforms is quite clear. The UK government is interested in preserving the country's reputation as an attractive venue for conducting business efficiently and for company rescue. This concern is especially acute in the light of Brexit.

The changes are potentially significant and have implications for companies across a number of sectors, including those operating in the trade of agricultural commodities. This article focuses specifically on (a) the new moratorium procedure; and (b) automatic termination provisions.

Moratorium

The new moratorium procedure is aimed at allowing companies time to consider their restructuring options. A company would not need to be insolvent in order to benefit from the new moratorium process.

The procedure itself will be modelled after the moratorium which is implemented when a company goes into administration, and has the effect of preventing creditors from starting or continuing legal proceedings against a debtor company in administration. Distressed companies often opt to enter administration in order to benefit from this moratorium, as it allows them to continue trading and to work towards rescuing their businesses. It effectively allows the company some "breathing space" to focus on arranging its affairs, without the threat of creditor action being taken against it. The intention behind this new process is to allow companies to address any solvency issues at an earlier stage, with a view to avoiding a formal insolvency process (such as administration or liquidation).

The new moratorium process will apply to solvent companies, who will need to demonstrate that they will become insolvent if action is not taken. The initial moratorium period will last 28 days and can be extended by the company for a further 28 days subject to the qualifying conditions being met. Any extension beyond 56 days will only be permitted with approval from more than 50% of secured creditors by value and more than 50% of unsecured creditors by value.

In terms of procedure, the new moratorium will be triggered by filing the appropriate notice with the Court. Once the moratorium has commenced, it will be supervised by a 'monitor', being a licensed insolvency practitioner who, while not taking control of the company during the moratorium, will ensure that the company continues to meet the qualifying criteria and protect creditor interests. The directors will retain control over the debtor company whilst it is in the moratorium process.

Automatic Termination Clauses

Another key announcement is that the government intends to legislate to prohibit the enforcement of automatic termination clauses in contracts. Also known as *ipso facto* clauses, these commonly operate as a contractual mechanism to allow a party to terminate a contract on the grounds that its counterparty has entered into a formal insolvency process and/or had insolvency proceedings commenced against it. This effective ban on *ipso facto* clauses will include the new moratorium process.

It is important to note that suppliers will still be able to terminate a contract on any other ground permitted under that contract, such as non-payment of liabilities incurred following entry into a moratorium, restructuring plan, or insolvency procedure. Certain types of financial products and services will likely be exempt from this ban as well.

This is a key consideration to bear in mind as the majority of Gafta proforma agreements contain a close-out clause which becomes effective upon a party's insolvency in certain circumstances. This has the effect of setting the relevant close-out price and thereby bringing the contract to an end.

Implications

As with any industry that experiences volatility, this may be a welcome development for agri-businesses trading through periods of financial distress.

The timeline for implementation of these reforms is uncertain at present. The government has indicated that it will seek to introduce new legislation 'as soon as parliamentary time permits'. It remains to be seen whether these proposals will affect Gafta contracts governed by English law generally, or will be applicable only if one (or both) of the parties to a Gafta contract is a corporate entity incorporated in England and Wales. The precise nature (and effect) of these proposed reforms will be made clearer once proposed legislation is published.