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CONSTRUCTION & ENGINEERING SOLICITORS

Construction Law Update

The Corporate Insolvency and Governance Act 2020 and the Construction Industry

The Corporate Insolvency and Governance Act 2020 (the **"Act"**) came into force on 26 June 2020. The Act introduces new corporate insolvency and restructuring measures that aim to maximise a company's chances of survival and relieve the burden on businesses caused by the COVID-19 pandemic.

Introduction

The Act effects wide-ranging changes to insolvency law and is made up of permanent and temporary measures. The provisions in the Act which are most relevant to the construction industry include a moratorium period which suspends the commencement or continuation of any legal proceedings, temporary prohibitions on winding up petitions being presented and restrictions on the ability to terminate supply contracts on the grounds of insolvency.

A further consideration is whether the introduction of the moratorium period will hinder the adjudication process and the ability to enforce an adjudicator's decision through the Technology and Construction Court.

The moratorium

The moratorium is a permanent measure introduced by the Act that prevents the commencement or continuation of legal proceedings against a company without the permission of the court. The purpose of the moratorium is to buy time so that companies can restructure or find new investment before having to succumb to formal insolvency proceedings.

The moratorium period is actioned by a company's director filing a notice at court. The initial notice will provide 20 business days of protection. This period can be extended by an additional 20 business days upon further notice being filed at court.

Restrictions on winding up petitions

The Act includes a temporary ban on the presentation of winding up petitions between 27 April 2020 and 30 September 2020. This ban applies to a company if it is subject to the aforementioned moratorium; or where a statutory demand has been served on the company between 1 March 2020 and 30 June 2020.

The Act also places restrictions on statutory demands served before 1 March 2020 unless the creditor has reasonable grounds to believe that COVID-19 did not have a financial effect on the company and that it would have become insolvent regardless of the financial impact of COVID-19.

The effect of insolvency upon contractual rights

The Act prevents suppliers from terminating a supply contract on the grounds that the customer (i.e. the party being supplied) is subject to a relevant insolvency procedure. For the purposes of the Act, a relevant insolvency procedure is where the company:

- effects the new moratorium;
- goes into administration or appoints an administrative receiver;
- agrees to a voluntary arrangement;
- goes into liquidation or appoints a liquidator; or
- is subject to an order under section 901C (1) of the Companies Act 2006 calling a meeting relating to compromise or arrangement.

The purpose of this prohibition on termination is to prevent the rescue of a struggling business from being jeopardised by its suppliers abandoning existing contracts. The provisions of the Act operate by invalidating any provision in a supply contract that permits the supplier to terminate, or do "any other thing", as a result of the customer's entry into an insolvency process.

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The prohibition on termination could affect any contractor or sub-contractor whose upstream client becomes subject to a relevant insolvency process by preventing them from terminating the contract. Further, the "any other thing" wording in the Act potentially also prohibits a contractor or sub-contractor from suspending performance due to non-payment under section 112 of the Housing Grants, Construction and Regeneration Act 1998 (the "Construction Act") if the reason for non-payment was the paying party's insolvency (although this appears to put the two pieces of legislation directly in conflict).

However, there are exceptions to the prohibition on termination. The first exception is temporary and allows small suppliers to be exempt from this rule until 30 September 2020. To be considered a small supplier, a company must meet two of the following conditions:

- turnover £10.2m or less;
- a balance sheet of not more than £5.1m;
- not more than 50 employees.

A further exception is where permission to terminate is granted by the court on the grounds that continuation of the contract would cause the supplier hardship.

In addition, the supplier can still terminate the contract if the administrator, administrative receiver, liquidator or provisional liquidator appointed over the insolvent company agrees or, where the insolvent company is subject to a moratorium or CVA, if the company agrees.

Adjudication

The moratorium introduced by the Act may prevent adjudication from commencing, as adjudication could be considered legal proceedings. This is yet to be confirmed because "legal proceedings" are not defined in the Act. However, the drafting of the Act is similar to the existing provision in the Insolvency Act 1986 which creates a statutory moratorium in administration. In the administration context, there is case law that referring a dispute to adjudication is prohibited, so it may well be that the same prohibition applies to the moratorium under the new Act. However, this would of course prevent a dispute from being referred to adjudication at any time pursuant to section 108 of the Construction Act, unless the court grants permission.

Even if adjudication is not prohibited by the new Act, whilst a company is protected by the moratorium, the moratorium will prevent the enforcement of an adjudicator's decision in the Technology and Construction Court (again, unless the court grants permission).

In either case, a restriction on the ability to start or continue an adjudication or adjudication enforcement proceedings would slow down what is meant to be a time-efficient process. It may also lead to companies filing notice at court to obtain the protection offered by the moratorium only so they can avoid the commencement of adjudication proceedings or being ordered to comply with an adjudicator's decision.

Analysis

The changes implemented by the new Act aim to alleviate the impact of COVID-19 on businesses in all sectors and industries across the UK economy. However, from the construction industry's perspective, some of the unique cashflow safeguards created by the Construction Act may be undermined by the new Act. This could to negatively impact the construction industry as contractors, suppliers and sub-contractors could be required to take on liabilities with potentially no recourse, in order to protect a company within the contractual chain that is either insolvent or protected by the new moratorium.

Existing and future contracts will need to be reviewed in light of the new risks created by the Act because the usual rights triggered by insolvency will no longer be enforceable in some circumstances.

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