

COVID-19: impact on goods and service providers in financial difficulty

Almost all organisations have external service providers facilitating their business. This can affect a vast range of services including IT, data processing, finance and accounting functions, security, payroll, cleaning and catering.

A result of COVID-19 is that an increasing number of organisations will face the situation in which a third party provider (whether a provider of goods or services) encounters financial difficulties.

This checklist sets out:

- some of the questions to consider if a provider does get into difficulty, and
- possible steps that you can take in advance to best protect your position should the situation arise.

Whilst the note refers to “service providers”, similar considerations will apply to the providers of goods.

The UK Government has announced its intention to amend current insolvency legislation to try and protect struggling companies in the current uncertain environment. This note will be updated once the details are known.

Initial questions for you

- How key is the service to your business and will the business suffer if there is any break in the continuity of the service?
- What is the full scope and extent of your relationship with the service provider, including all your divisions and subdivisions?
- For key services, what aspect of the service is important to your business (e.g. physical assets, intellectual property rights, specific personnel)?
- Are you familiar with the contract - particularly the circumstances in which you can terminate/enforce the agreement (see below)?

With key service providers, consider whether it is better to terminate the agreement or whether you might be better served proactively approaching the service provider and offering enhanced terms or even financial support (either permanently or temporarily) to help them find a solution to their problems. Consider also whether the contract contains suspension rights giving the parties the ability to suspend the contract to allow the key service provider time to attempt to resolve the financial difficulty it is in.

Note that in these circumstances there may be a shift in commercial bargaining power as you may now be dependant on the service provider. At the least, such an approach can buy you time to consider alternatives and may precipitate management action at the service provider which ensures continuity of service. For example, management considering a pre-packaged administration buy out may be concerned that clients may not follow them - proactively demonstrating that you will could help the decision and ensure complete continuity.

- If renegotiating terms is an option, are there any other provisions which should be added into the

agreement at this stage (e.g. an obligation to retain personnel that are key to your business)?

- Do you already know of alternative service providers who could take over the function? Can you take the service in house for a period? (Note TUPE implications.)

Review your contract with the provider

- Does it deal with the situation at all?
- Does it contain “step in” rights? If so, what grade of rights does this give (ability to take the services back in house, recover equipment owned by you, enter premises, transfer the goods and services to an alternative provider, etc)? (Note taking a contract back in house could involve (TUPE) transfer of liabilities back to you). Consider how these step in rights work in practice.
- In what circumstances can you terminate or enforce the agreement?
- Does the service provider have the right to assign or novate the contract?
- What are the payment arrangements - are you paying in advance?
- Does title to the goods pass on delivery or on payment?
- Can you give notice in these circumstances (and if so how much would be needed)?
- Where the service provider has sub-contracted parts of the service, what are your rights in relation to the sub-contractors? Can you call for the automatic assignment or novation of the sub contract to you or otherwise directly enforce rights against sub-contractors?

Questions to ask of a service provider

- Exactly what position are they in?
- Have they instructed external advisers (i.e. accountant/insolvency practitioner)? If so, can you speak to them to get a clearer picture?
- What are their thoughts in relation to resolving the situation (are they anticipating going into an insolvency process i.e. administration?)
- For key service providers - would renegotiating terms alleviate the situation?

(Note - they may not be aware of the full picture so answers may not be definitive.)

Questions to ask of the administrator

- Exactly what stage are they at? (Different TUPE provisions apply to different situations which is likely to impact on strategy)
- Do they intend to continue, terminate, assign/novate the contract?

- Is it possible to agree that future payments are ring fenced to guarantee continued service provision?

Notes for you

- Ensure existing payments are put on review (not stopped) - to avoid paying a month in advance the day before an organisation goes into an administration process.
- At what stage can you contact a new provider?
- Getting property back (even that owned outright, such as a server you own hosted by the service provider) may not be simple in practice without the leave of the court. Administrators and/or landlords can deny access.

Protecting yourself in advance of the event

- Ensure business continuity plans cover service providers getting into difficulty.
- Consider putting together a rapid reaction team to deal with individual situations should they arise.
- Consider carefully the steps you take, they might constitute a waiver of rights or a repudiatory breach if not properly supported by the contract.
- Review existing contracts:
 - do they contain provisions dealing with insolvency/bankruptcy/ administration of service provider/step in rights?
 - do existing exit plans need to be updated to reflect your requirements on termination of services?
 - do you need to include provisions dealing with rights in relation to sub-contracted parts of the service in the event that the main contractor goes under?
- Consider restructuring payment arrangements – e.g. where the service provider is co-ordinating sub-contractors, payment could be made direct to sub-contractors, so the funds are not used for the service provider’s general finances.
- Consider credit worthiness checks on any service providers of concern.
- Consider entering into a side letter with service providers making it clear what your rights are in these circumstances. (Note - it may not be enforceable if the service provider does subsequently go into insolvency but legal argument can come later!)
- Where appropriate, consider diversification of supply base.
- Note - organisations regulated by the Financial Conduct Authority should bear in mind regulatory obligations.
- Purchasing performance bonds - put on the procurement checklist for future contracts (in better financial circumstances).

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