

Construction Insolvency

The downfall of William Verry, David McLean, Mann Construction and the recent administration of Connaught has brought construction-related insolvency to the national spotlight again and serves as a reminder to employers to take all appropriate steps to protect their interests in the event of contractor insolvency.

Contractor insolvency delays projects, increases costs and more often than not it deprives the employer of remedies and third parties of meaningful warranty protection. How then can an employer protect his position?

It is essential to thoroughly check the contractor's financial position before entering into a building contract. It would also be prudent to carry out the checks periodically during the works, and look out for early indications of financial difficulty. For example, the contractor's sub-contractors and/or employees often moan on site about not being paid by the contractor. The earlier the employer becomes aware of the problems, the more time he will have to prepare.

If the contractor is a subsidiary company, consider obtaining a parent company guarantee from its parent company (or, where there is a group of companies, from the relevant company which owns or controls the net assets). Ensure that the terms of any parent company guarantee offered by a guarantor offer the adequate level of protection.

Keep in mind that, quite often, a subsidiary's insolvency may be accompanied by the insolvency of other group companies (including the parent company); so consider whether a performance bond should also be obtained. Unconditional (on-demand) bonds would offer the best protection but are becoming increasingly rare in the current economic climate. Default bonds are more common. Again, it is important to review

the wording of any bonds offered by a contractor's surety.

Insolvency of the contractor also means that the employer is often left without an enforceable remedy against the contractor for future defects. The employer should therefore ensure that it gets collateral warranties from sub-contractors and consider taking out a latent defects insurance policy in respect of future defects.

It would be preferable for the building contract to have insolvency events of default defined as widely as possible and for determination of the contract on insolvency to be at the employer's option by notice. This optional period may allow some dialogue between the employer and the contractor or with the contractor's insolvency practitioner; and agreement may be reached for the completion of the works rather than termination of the contract.

Ensure that the building contract contains suitable provisions to deal with insolvency and its consequences. These include, for example, provisions:

- to ensure that there is no payment obligation on the employer following the insolvency event (only any surplus moneys should be payable after another contractor has completed the works);
- in the main contract (and sub-contracts) to deal with the passing of title to the employer of on/off-site materials;
- to ensure that if the employer is to make advance payments to the contractor, or is to forgo the right to hold a retention, bonds are provided to the employer on appropriate terms;

- requiring the provision of collateral warranties from sub-contractors, containing 'step-in rights' (enabling the employer to step-in to the main contractor's position under the relevant sub-contract before the sub-contractor can terminate the same for the main contractor's insolvency).

Following insolvency of the main contractor, employers will often wish to terminate the building contract but will want to retain sub-contractors on site to complete their respective works. Sub-contractors are unlikely to stay on site unless they are paid for any unpaid work they have done for the contractor before termination of the building contract. Making such payments to sub-contractors carries the risk of double liability (i.e. to the contractor and the sub-contractor). The contractor's insolvency practitioner will argue that payments for works carried out before the date of determination should be paid by the employer to the contractor for distribution to the contractor's creditors. Despite this, it may still be in the commercial interests of the employer to "do a deal" with the sub-contractor to ensure the works are completed.

In the event (or risk) of insolvency of a contractor, the employer should always take all steps to secure the site and plant/machinery.

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