

LEGAL INSOLVENCY IN THE CONSTRUCTION INDUSTRY



Protect yourself first, offer assistance later, is the advice from **Jake Davies** for any business that suspects it is working with a firm in jeopardy

Insolvency is a big risk in the construction trade because of the industry's cyclical nature and its collect early, pay late culture. Firms often operate on a low profit margin with no fixed assets and low capital but high cashflow and high return on capital.

To minimise risk when commencing projects, it is always worth ascertaining covenant strength. If unsatisfactory, procuring some security for performance is sensible. Contractual agreements must be properly documented to avoid doubts should a party later become insolvent.

Late payment and payment schedule changes are obvious signs of insolvency but a slowdown on site and/or of service delivery should also sound alarm bells, as should the withholding of payment on the basis of unexpected claims.

If any of these indicators occurs, there are various options prior to formal insolvency proceedings. The position that should be adopted, however, is that insolvency will follow and the entity in financial difficulty should be helped, but not to the detriment or at the risk of the party lending assistance.

Termination or suspension

Does the contract allow termination at will? If not, has there been a breach that would allow termination? Any process to determine needs to be followed correctly. Also, efforts should be made to secure all information and/or items for which advance payment have been made.

Assistance

A request for assistance to allow delivery to be procured may be made. If the payment procedure under a contract is varied, this should be clearly documented.

If payment terms are varied then so should be terms for security rights, step in, outstanding information provision, etc, to ensure that the risk apportionment in the contract remains appropriate.

Contract security

If performance bonds and parent company guarantees have been procured these should be examined closely to ensure that any action taken with regards to the overlying contract does not discharge the obligations of the bondsman or parent company guarantor.

Procedures set out in security documentation should be followed closely to prevent avoidance. Claims should be made as early as possible.

Securing the site/possession of information

In the event of main contractor insolvency, taking possession of the site needs to be considered closely, especially if administrators remain in control of the company and liquidation has not begun.

On outstanding design information, care should be taken to ensure that anything that should have been provided has been, particularly health and safety records. Consultants should tie delivery of such items to payment.

Formal insolvency proceedings

The position alters significantly once administrators or liquidators are appointed because of their power to avoid contractual liabilities. A claim in the insolvency should, nonetheless, be made. Insolvency practitioners and other creditors should be contacted to assess what, if any, agreements can be reached to procure finalisation of the project.

In conclusion:

- consider the potential for insolvency at the start of any project and put in place mechanisms to protect yourself; and
- if any of the indicators of insolvency, appear, act quickly to protect yourself.

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