

# Insolvency solutions

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## Following the collapse of Carillion, Daniel Hutchings helps identify the early warning signs of contractor insolvency and advises how to respond

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In a post-Carillion world, the spectre of insolvency can haunt a project. [Research](#) carried out immediately after the major contractor's collapse indicated that the rate of UK construction insolvencies rose by some 8% in 2016/17, with more than 2,600 such companies falling into insolvency.

Insolvency can happen suddenly, but steps can be taken to avoid the most unpleasant of outcomes: an unfinished project, a building riddled with defects, no security for the developer's cross-claims, and an unhappy client looking to blame the contract administrator.

Any of the following patterns of behaviour or changes in the way the project is progressing may indicate that your client's contractor is in difficulty:

- contractor demanding swift payment, early release of retention or any other changes in payment patterns;
- subcontractors contacting your client directly, seeking payment;
- withdrawal of labour, including changes to key individuals on site;
- less frequent deliveries or removal of various goods and materials from site;
- a general slowdown in the progress of the works; and
- increased number of defects.

## Meticulous planning

At the early warning stage you should exercise caution and establish whether your concerns are correct, because mistaken allegations will likely erode confidence and trust. Gather all relevant information, particularly with regard to payment and value of works. If the contractor is teetering on the edge, then denial of cash flow may result in the unwanted distraction of adjudication or push it into insolvency.

If you suspect that insolvency is impending, your client will be looking to you to help assess the situation. Do you advise it to terminate the contract, or think about ways it can encourage and assist its ailing contractor to finish the project? The following factors ought to be taken into account:

- How close are you to the end of the project? How many stages are remaining? Is practical completion imminent? Could there be an issue with the transfer of existing design liability to any new contractor?
- Is there a performance bond? Will your client have access to funds to cover the cost of completing the work? Ordinarily, this will depend on the nature of the event and the wording of the bond. Even on the occurrence of an insolvency event, it may not be possible to make a call without having first obtained the decision of an adjudicator. If so, proceedings may need to be instigated before the date of the relevant event, to avoid the prospect of them being stayed pursuant to insolvency

laws.

- Is there a parent company guarantee? If so, what is the financial position of the parent? Is the rest of the group sound, in financial terms?
- How is the project financed? Is there a fund or lender that your client should involve in the decision-making exercise? Does the scenario that your client is facing constitute an event of default under any funding arrangements?
- Is the contractor in breach of contract, and does this entitle your client to terminate? This requires careful thought. If your client gets it wrong, the contractor may be able to claim there has been a repudiatory breach of contract and seek damages for wrongful termination.
- Can your client quickly build out the works? Is a replacement contractor available and can you keep trusted and reliable subcontractors by exercising step-in rights?

## Steps to take

If you have immediate concerns you will need to:

- monitor the contractor's performance closely, both on site and financially;
- consider regular site visits;
- keep detailed records;
- ensure compliance with payment procedures, so any payments are in line with the work completed and any 'pay less' notices are served in time and to the correct address;
- keep on top of defective work, consider issuing formal instruction to open up or test materials or goods, or remove defective work; and
- check the construction contracts and ask your client about funding arrangements as well.

Where there are defects, analyse whether your contract allows your client to engage others, should your instructions in relation to the same be ignored. Ensure you meet any deadlines in such a scenario.

This can be an effective strategy, especially if the contract provides that the contractor will be liable for all additional costs incurred by the client in connection with any such engagement.

A composed approach, taking into account the steps above, may not wholly avoid a tricky period for the project. But protecting your client's position and offering practical advice during a difficult time is unlikely to go unnoticed. You'll be rewarded, as calm heads are welcome in any team.

[Daniel Hutchings](#) is a senior associate at law firm [Taylor Wessing](#)

## Further information

- Related competencies include: [Contract administration](#) and [Works progress and quality management](#)
- This feature is taken from the [RICS Building Surveying Journal](#) (July/August 2018)
- Related categories include: [Managing insolvency](#)