

My Contractor Has Gone Bust — What Should I Do?

BRIEFING

According to recent research by PricewaterhouseCoopers, construction insolvencies have risen 35% year-on-year. The upward trend is set to continue and is sadly an inevitable consequence of today's faltering economic climate. From an Employer's perspective, the insolvency of their contractor could spell disaster as projects may be left incomplete with inevitable resulting delays to planned completion and increased costs. So what action should you take if your contractor becomes insolvent?

Action to be taken

Employers must scrutinise the terms of the construction contract governing the particular project to establish the procedures to be followed and the rights of the Employer in such an event. There are lots of different forms of construction contract and each form will adopt a slightly different approach in the event of contractor insolvency. Note that contracts will usually make a distinction between different types of insolvency but for the purposes of this article the term insolvency is used to cover all types.

An Employer must take immediate action as soon as he hears that his contractor **has** become insolvent. Depending on what the contract says, such action may include:

1. Secure the site and ensure that no plant tools machinery, or materials are removed. Specialist

security firms exist with experience of security issues in the event of contractor insolvencies.

2. Terminate the contract.
3. Exclude the contractor from the site.
4. Suspend further payment to the contractor until works have been completed and the final account has been prepared. Contractual set off can then be made between what would have been due to the contractor had he performed the contract and the actual cost incurred by the Employer by having work completed by an alternative contractor, together with any loss resulting from the termination.
5. Check ownership of plant and materials. The contract may expressly allow for the Employer to take possession of the contractor's kit and sell it using the proceeds against any contractor debt. This can be a very useful provision as the kit may be worth tens of thousands of pounds. There may also be a deeming provision providing that all kit owned by a contractor when on site shall be the property of the Employer if the contractor becomes insolvent and that the Employer can sell it and the put the proceeds towards satisfaction of any sums due. These provisions are complicated by the fact that an Employer must register the right to sell the kit as a floating charge against the contractor within a certain timescale and so legal advice should be sought before any kit is sold to ensure this is



permissible. Note in respect of title to materials fixed to the land, this will vest in the owner of the land by operation of the law.

6. Check to see if you have the right to use any of the contractor's designs going forward. If so, these will need to be obtained if not already in the Employer's possession.
7. Appoint a replacement contractor to complete the works or alternatively an Employer may wish to appoint the existing sub-contractors directly in which case, subject to the terms in the contract, the sub-contracts may be novated over to the Employer.
8. Check to see if there is a bond or a guarantee in respect of the project. If so, an Employer may be able to make a call on this document to meet losses incurred by the Employer in respect of the contractor's insolvency. However, note that there are set procedures that must be followed in order to recover any such losses.

Further considerations

One further point to consider. The contractor's insolvency practitioner once appointed will want to ensure that he receives as much value out of the contract as he can and for that reason it may be in his interest to arrange for the works to be completed by the existing contractor (through the insolvency practitioner) or to novate the existing contract to another contractor with the Employer's consent. This may not always be possible because construction contracts invariably contain provisions whereby the contract can be terminated, sometimes automatically, upon the occurrence of an event of

insolvency and an Employer would normally want to terminate. If the contract has already been terminated then clearly it cannot be novated. If an Employer has not yet terminated the contract, then when deciding how to facilitate the recommencement of the works he must consider the quality of works done to date (in the event that the proposal is that the contractor finishes the works) and whether he wants to procure the project in a different way now (in the event that the proposal is novation of the existing contract to an alternative contractor).

Conclusion

It is clear that there are steps that the Employer can take to minimise his risk in the event of contractor insolvency but that careful analysis of the relevant contract must take place first to establish what can and cannot be done. If a project has not yet commenced and a contract has not been signed then there are certain preventative measures that an Employer can take to minimise his risk. These include carrying out financial checks on the contractor prior to a project taking place and ensuring that legal advice is sought prior to entering into construction contracts to ensure that it contains sufficient rights for the Employer should an event of insolvency occur.

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