In the final part of this series, we look at how you can protect your position and be prepared in the event of an impending insolvency.

- **Thinking ahead**
- **Contractual safeguards**
- **Payment mechanism**
- **Contemporaneous records**
- **Spotting the warning signs**
- **Security**
- **Third party agreements**

**Thinking ahead**

It is always prudent to assess insolvency risk before finalising a contract. The trading history and financial position of a company should be carefully reviewed and a financial risk assessment made at both the outset and during the lifetime of a project. Obtain an up to date set of accounts and a credit report before entering into your contract to enable you to assess the counterparty’s financial viability.

**Contractual safeguards**
From the very start of a relationship, long before an insolvency situation arises, it is important to check what contractual terms will apply in the event of insolvency. Part 3 of our mini-series covers this in more detail.

You may want to look at making amendments to your standard contract wording in order to further enhance protection. For example:

- include express clauses so that there is no further obligation to make payment until works are complete;
- the ability to engage other contractors to complete the works, with the cost of doing so being (a) recoverable from, or (b) offset against sums owed to the insolvent counterparty; and
- termination clauses should be drafted carefully to ensure that you can have the option to terminate the contract immediately when an insolvency event occurs.

**Payment mechanism**

A project bank account may safeguard funds meant for the contractor's subcontractors and suppliers which would otherwise be swallowed up in the contractor's bank accounts. Whilst it costs money to set up and increases the administrative burden, it may be particularly advantageous in circumstances where the employer needs the sub-contractors' and suppliers' co-operation to complete the works.

**Contemporaneous records**

During the course of a project, you should keep detailed records of site meetings, progress meetings and general communications. Keep also a watching brief on the entity's record keeping and project reporting. This will assist in monitoring the financial performance of the entity.

You should, in any event, look at your contracts to obtain up-to-date design documentation, reports and programmes to ensure that if you have to terminate and engage others, you have all the relevant information in order to finish the project.

**Spotting the warning signs**

There are often early warning signs that a company is in financial difficulty. Not all businesses decline at the same rate. The challenge is to spot the signs of decline and react ahead of any insolvency. Monitoring risk cannot be done in isolation by commercial representatives / project managers. Consider taking a whole team approach and training your staff to understand the
options available to them and to be vigilant for:

Site specific examples:

- a high turnover of employees;
- a general decrease of labour on site;
- slow-down in progress of the works and / or not delivering in accordance with agreed timescales or to a poor standard;
- an increase in the number of defects in the works;
- removal of plant, equipment and/or materials from site.

Commercial examples:

- requests from the supply chain for deposits, upfront payments or reduced retentions;
- attempts to inflate payment applications or pursue spurious claims and/or contra-charges to increase the amount payable to it;
- complaints from other members of the supply chain as to delays in payment or non-payment;
- lack of response to ongoing correspondence;
- silence and evasion tactics and/or a more contentious approach;
- failure to file / late filing of statutory accounts or annual returns;
- rumours and market intelligence about the company’s financial position - although this information should always be treated with caution.

Also put in place a chain of command for reporting concerns over the insolvency of supply chain members.

Security

Consider the group structure and stability. Check that all bonds and parent company guarantees are in place. If not, take steps to procure the same. The building contract should also include sanctions if the building contract fails to procure a required bond or parent company guarantee. For example, the employer/contractor could insert a provision entitling it to withhold payment of a specified sum from the contractor/subcontractor until the missing document is produced.

Check any technical requirements or pre-conditions about the way in which a claim must be notified to the bondsman or guarantor. You should carefully consider if the bonds provide for a right to make a claim on the occurrence of an insolvency event without first having to obtain the decision of an adjudicator or a decision in any other form of dispute resolution. Ensure that you are familiar with the terms of any parent company guarantee and check that the guarantor’s obligations will not be discharged by for example:
a. terminating the contractor’s employment under the building contract;
b. renegotiating the scope of works with the contractor or varying the underlying building contract without first obtaining the guarantor’s consent;
c. reaching a settlement with the contractor;
d. employing a new contractor if the guarantor has a duty to complete the works.

**Third party agreements**

The building contract should include an express requirement for the contractor to procure collateral warranties or the grant of third party rights (under the Contracts (Rights of Third Parties) Act 1999).

Check that all necessary collateral warranties have been procured in accordance with the terms of the contract. If not, take steps to obtain any missing collateral warranties (together with the underlying contracts). Contractor insolvency may mean that the employer is left without an enforceable remedy for future defects. Therefore, the employer should insist on collateral warranties (together with a copy of the underlying contract) from the contractor’s material and/or design subcontractors and consultants so that it has right of recourse against a solvent counterparty.

If third party rights are being granted instead of collateral warranties, check that all notices granting third party rights have been issued.

You should consider your funding and joint venture arrangements (if any) as well as sale agreements to see whether this gives rise to any events of default or other rights for those entities. Check that no agreements will be breached if, for example, the contractor is terminated without third party consent. For example, under a facility agreement, the bank’s consent is normally required before terminating the contractor’s employment. It is likely that the contractor entering into administration or becoming insolvent will be an event of default under the facility agreement in any event.

If you do need advice on these or any related issues, please contact Sue Ryan or one of our Restructuring & Insolvency experts

**Other parts in the insolvency in construction series**

- [Insolvency in construction: what is insolvency?](#)
- [Insolvency in construction: What does this mean for your contract?](#)
- [Insolvency - in contract with an insolvent company - what now?](#)
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