

INSOLVENCY IN CONSTRUCTION: WHAT DOES THIS MEAN FOR YOUR CONTRACT?

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In the second of our mini-series on insolvency in construction, we consider what you need to do when you find out that the party you are in contract with has become (or is about to become) insolvent.

- [Who are you in contract with? Which specific entity?](#)
- [Does the contract terminate automatically?](#)
- [How does the contract define insolvency?](#)
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Who are you in contract with? Which specific entity?

The first thing you should do in the event of a counterparty's alleged insolvency is check which legal entity you are in a contract with.

This is in order to prevent you from acting too early and committing a repudiatory breach yourself, if you take pre-emptive action against your counterparty.

Information is available through a variety of sources including searches of the public registers at Companies House and at the courts or credit agencies. Alternatively, if you believe an Insolvency Practitioner has been appointed, you can contact him or her for confirmation.

Does the contract terminate automatically?

You should be aware that absent a specific contractual right, insolvency is not a breach of contract under English law. You cannot therefore simply rely on a right to terminate for default or breach - express wording dealing with insolvency is required.

Standard form contracts do not generally provide for automatic termination on insolvency. Most construction contracts do however provide a right to terminate the contract upon the employer's or contractor's insolvency. You should check how widely the contract defines insolvency for these purposes as well as the procedure to be followed. It is important to check that the particular circumstances involved constitute insolvency as defined by the contract.

Getting this wrong (whether or not those specific events have occurred and/or the correct procedure to follow) could give rise to wrongful repudiation of the contract, termination rights and a claim for damages - which may, for example, include loss of profits on the overall project, or the cost of engaging others to complete the works and claiming the difference from you.

It generally pays to plan for the worst case scenario. Check whether the contract deals with insolvency and its consequences. This will include for example:

- no payment obligation following insolvency;
- no automatic termination of the main contract on insolvency (to allow flexibility and the ability to liaise with the insolvency practitioner where possible);
- early insolvency triggers to give the employer more time to consider its position;
- provisions in the main contract and subcontracts that deal with the passing of title to the employer for on and off-site materials; and
- collateral warranties / third party rights.

How does the contract define insolvency?

Every contract is different and many are likely to be subject to bespoke amendments.

Ideally "**Insolvency event**" should be defined widely enough to catch events which occur before the formal insolvency process begins such as winding-up petitions being issued or a notice of intention to appoint administrators being filed.

As a starting point, the standard form contracts listed below define insolvency and set out

the relevant procedure as follows:

Standard form contracts

JCT Design and Build 2016^[1] (Contract Conditions, Section 8)

Definition of insolvency

A company:

- entering into administration;
- appointing an administrative receiver or a receiver or manager;
- passing a resolution for voluntary winding-up; or
- becoming the subject of a winding-up order

An individual or partnership:

- becoming the subject of a winding-up order;
- sequestration of the estate or the grant of a trust deed for creditors;
- entering into an individual voluntary arrangement with creditors.

Employer action (for contractor's insolvency)

The employer can terminate the contractor's employment at any time.

The contractor's works obligations are suspended from the date of insolvency. Whether or not termination occurs, payment stops until after completion of the works and making good defects.

If the employer terminates, it may take possession of the site and employ others to carry out and complete the works. The contractor cannot hinder or delay the taking of these measures.

The employer will have to pay the contractor the balance due, if any, upon completion of the works by others.

JCT Design and Build 2011^[2] (Contract Conditions, Section 8)

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Contractor action (for employer's insolvency)

NEC3 Engineering and Construction Contract^[3] (Clauses 90 - 92 and Termination Table)

Definition of insolvency

An individual who has:

- presented their petition for bankruptcy (R1);
- had a bankruptcy order made against them (R2);
- had a receiver appointed over their assets (R3);
- made an arrangement with their creditors (R4).

A company or partnership that has:

- had a winding-up order made against it (R5);
- had a provisional liquidator appointed to it (R6);
- passed a resolution for winding-up (other than in order to amalgamate or reconstruct) (R7);
- had an administration order made against it (R8);
- had a receiver, receiver and manager, or administrative receiver appointed over the whole or substantial part of its undertaking or assets (R9); or
- made an arrangement with its creditors (R10).

Employer action (for contractor's insolvency)

The employer may terminate for any reason under NEC3.

If the contractor is insolvent the employer may terminate and pay a third party to complete the works. It can also instruct the contractor to leave the site, assign the benefit of subcontracts and use any equipment to which he has title that remains on site.

NEC4 Engineering and Construction Contract^[4] (Clauses 90 - 92 and Termination Table)

Definition of insolvency**An individual who has:**

- presented his petition for bankruptcy (R1);
- had a bankruptcy order made against him (R2);
- had a receiver appointed over his assets (R3);
- made an arrangement with his creditors (R4).

A company or partnership that has:

- had a winding-up order made against it (R5);
- had a provisional liquidator appointed to it (R6);
- passed a resolution for winding-up (other than in order to amalgamate or reconstruct) (R7);
- had an administration order made against it (R8);
- had a receiver, receiver and manager, or administrative receiver appointed over the whole or substantial part of its undertaking or assets (R9); or
- made an arrangement with its creditors (R10).

Employer action (for contractor's insolvency)

The employer may only terminate under NEC4 if the relevant secondary option has been chosen.

If the contractor is insolvent the employer may terminate and pay a third party to complete the works. It can also instruct the contractor to leave the site, assign the benefit of subcontracts and use any equipment that remains on site.

FIDIC Yellow Book^[5] (Clauses 15 and 16)

L

Definition of insolvency

A party becomes bankrupt or insolvent, goes into liquidation, administration, reorganisation, winding-up or dissolution; becomes subject to the appointment of a liquidator, receiver, administrator, manager or trustee; enters into a composition or arrangement with the Contractor's creditors; or if any act is done or event occurs which (under applicable Laws) is analogous to or has a similar effect to any of these acts or events.

Employer action (for contractor's insolvency)

Immediate termination of contractor's employment.

The contractor is required to leave the site and comply with any reasonable instructions given by the Employer to assign the benefit of subcontracts and protect the site.

The employer may engage a third party to complete the works.

The **Engineer** must determine the proper value of the works at the date of termination.

The employer may withhold any further payments until all costs and losses to complete the works are established. The employer may then recover these from the contractor (or lodge a proof of debt for the same).

Contractor action (for employer's insolvency)

The contractor shall promptly cease all further work, except for such work as may have been instructed by the **Engineer** for the protection of life or property or for the safety of the works.

FIDIC Silver Book^[6] (Clauses 15 and 16)

L

Definition of insolvency

A party becomes bankrupt or insolvent, goes into liquidation, administration, reorganisation, winding-up or dissolution; becomes subject to the appointment of a liquidator, receiver, administrator, manager or trustee; enters into a composition or arrangement with the Contractor's creditors; or if any act is done or event occurs which (under applicable Laws) is analogous to or has a similar effect to any of these acts or events.

Employer action (for contractor's insolvency)

Immediate termination of contractor's employment.

The contractor is required to leave the site and comply with any reasonable instructions given by the Employer to assign the benefit of subcontracts and protect the site.

The employer may engage a third party to complete works.

The employer's representative must determine the proper value of the works at the date of termination.

The employer may withhold any further payments until all costs and losses to complete the works are established. The employer may then recover these from the contractor (or lodge a proof of debt for the same).

Contractor action (for employer's insolvency)

~~The contractor shall promptly cease all further work, except for such work as may be~~

Impact on subcontractors and suppliers

Check the terms of any contract with the supply chain including for example:

- any "pay when paid" clauses entitling you to withhold payments when the upstream payer has become insolvent. These are permitted by s113 of the Housing Grants, Construction and Regeneration Act (HGCRA) 1996 but narrowly construed.
- any termination provisions which may operate automatically. For example, clause 7.9 of the Joint Contracts Tribunal (JCT) Design and Build Sub-Contract Conditions 2016 provides for a scenario where the contractor's employment under the main contract is terminated. In such a scenario, the sub-contractor's employment under the subcontract shall also automatically terminate and the contractor shall immediately notify the subcontractor.

Employer Step-in Rights

If the company has provided collateral warranties, these may include step-in rights by the employer. If step-in rights are included there may be a number of additional considerations. Step-in provisions allow the employer to step into the shoes of the contractor if the contractor becomes insolvent.

The ability to step-in should be exercised with caution - you should be aware, for example, that often you will take on liability for any outstanding or unpaid amounts.

Notice Provisions

Carefully check the notice provisions in your contract so as to ensure you follow the correct procedure. You want to avoid a situation where a technical point is raised as to the validity of service.

In our next article in the series we look at the practical issues associated with insolvency.

Insolvency is a complex and specialist area of law, so 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 contract with an insolvent company - what now?](#)
- [Insolvency in construction: Looking ahead and minimising risks](#)

Footnotes

[1] The Joint Contracts Tribunal Limited (JCT), Design and Build Contract, Thomson Reuters, 2016.

[2] The Joint Contracts Tribunal Limited (JCT), Design and Build Contract, Thomson Reuters, 2011.

[3] NEC3 Engineering and Construction Contract, 3rd Edition Reprinted with amendments 2013, Thomas Telford Ltd, 2013.

[4] NEC4 Engineering and Construction Contract, 4th Edition, Thomas Telford Ltd, 2017.

[5] Conditions of Contract for Plant and Design-Build: The Yellow Book, Second Edition, The International Federation of Consulting Engineers (FIDIC), 2017.

[6] Conditions of Contract for EPC/Turnkey Projects: The Silver Book, Second Edition, The International Federation of Consulting Engineers (FIDIC), 2017.

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