

STRATEGIC PLANNING & PLACE BUILDING CONTRACT DIRECTIVE

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REFERENCE

PROCEDURES TO BE ADOPTED UPON THE INSOLVENCY OF A CONTRACTOR

1. A multitude of problems arise when one of the parties to a building contract (usually the contractor) becomes insolvent. The following notes have been prepared for guidance from the County Council's perspective, as Employer under the contract or contracts.

The County Council is obliged to mitigate its loss. It must also comply with insolvency law and other legislation and with the Council's own Standing Orders and Regulations.

The terms "receiver", "liquidator", "bankrupt", etc, are freely and inaccurately used by most people. Each has a specified meaning and they are not interchangeable.

The rules in some aspects are complex, one judge stated that "the rules of set-off are based on no coherent line of reasoning", so do not hesitate to consult the Chief Monitoring Officer and/or Management Audit for advice.

There was an updating and overhaul of insolvency practice caused by the Insolvency Act of 1986. The 1986 Act was subsequently modified by the Enterprise Act 2002 and the Small Business, Enterprise and Employment Act 2015.

The major change was the introduction of the 'Insolvency Practitioner'. Previously anybody could be appointed as a receiver/liquidator, this could, and did, give rise to a dubious practice. Insolvency Practitioners are now licenced by the Secretary of State.

The following procedures are listed in the Act:-

1. Administration
2. Liquidation (Compulsory and Creditors Voluntary Liquidations)
3. Administrative receivership

2. **Administrative Receivership**

Under this arrangement the Administrative Receiver is normally appointed by a secured creditor (usually a bank) (debenture). The appointment has immediate effect. His main duty is to realise the secure assets for the benefit of the creditor who arranged the appointment and also for the benefit of preferential creditors who have legal priority. Any surplus is distributed to the unsecured creditors/shareholders.

The Administrative Receiver's powers derive from the debenture under which he is appointed and from the Insolvency Act 1986. These powers include the power to:-

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NOTE:

THIS DIRECTIVE IS APPLICABLE TO THE MAJORITY OF SCHEMES BUT IT WILL NOT NECESSARILY BE APPROPRIATE TO ALL WORKS AND THEREFORE ON EACH SCHEME IT WILL BE NECESSARY TO CHECK THE SPECIFIC REQUIREMENTS.

1. take possession of and sell the asset of the company;
2. carry on the business of the company;
3. borrow money on the security of the assets;
4. appoint agents;
5. instigate or continue legal actions;
6. carry out acts incidental to the performance of these duties;
7. petition the Court for the winding-up of the company.

The Administrative Receiver also has a duty not to diminish such assets as remain, so he/she is unlikely to enter into unprofitable contracts.

Key points are:-

1. Appointment imposes a stop on payments to creditors.
2. Administrative Receiver has wide power to carry on the business.
3. Administrative Receiver's appointment has immediate effect. There is no hiatus period as in liquidation.
4. Administrative Receiver acts as agent of the company with personal liability on any contract entered into by him in the carrying out of this function unless he contracts out.
5. An Administrative Receiver and a liquidator can both be appointed to a company at the same time.

3. **Administration**

This was introduced by the Insolvency Act 1986 and revised by the Enterprise Act 2002 and allows a breathing space for the company so that it can arrange its affairs without the pressure of creditors. The administrator is appointed by the Court to take over management of the company in the interests of all creditors, whereas the Administrative Receiver's primary duty is to the debenture holder. Alternatively, the directors or a floating charge holder can appoint their own administrator without a court hearing simply by filing papers at court.

The intention is to return the company solvent to its directors, or failing that an arrangement with its creditors or finally to liquidate the company.

Key points are:-

1. Moratorium on payments to pre-Administration creditors.
2. Wide powers to manage and realise the company's assets.
3. General duty to the company and all creditors.
4. Process instigated by the Court on company or creditor petition.
5. Administration precludes any other insolvency procedure while the Administration order is in force.
6. Administrator has no automatic personal liability but post-Administration commitments are subject to a statutory charge.

4. **Liquidation**

This is the legal process of winding up a company and distributions of assets firstly to its creditors and then to its members.

There are three types:-

- a) Compulsory – ordered by the Court.
- b) Creditors Voluntary – Creditors decide.
- c) Members Voluntary – Directors decide.

The first two are insolvent liquidations and the last is solvent (all creditors will be paid in full). The Court and the Official Receiver (a civil servant) are involved and the O.R. often appoints an insolvency practitioner in his stead. This can be a slow process, meetings, etc, have to be held and formal notices placed, which

can take several weeks.

Liquidation is closing the company down; not trying to allow it to survive.

5. **Voluntary Arrangements with Creditors**

This procedure is brought about by the company proposing an arrangement providing for deferred payment of part or all debts out of future profits. It is normally supervised by an Insolvency Practitioner. They cannot bind a secured or preferential creditor. There is no moratorium until it is in place, so creditor can queue jump. Despite this, it is a procedure which can offer company rescue. These are the different procedures that can occur. Administrative Receivership and Liquidation are the most usual.

6. **Financial Difficulties – Early Signs**

The first indications of a problem quite often start as a rumour. Early signs may include:

- Commonly, sub-contractors fail to receive prompt payment, resulting in withdrawal of labour from site, and/or for similar reasons delays occur in the delivery of materials
- Increase in defects
- Contractor seeking to negotiate further payments or release of retention or any other change in payment patterns
- Contractor raising spurious or unjustified claims or contra-charges to increase the amount payable to him
- Contractor assigning proceeds of a building contract to a bank or other creditor
- If the Contractor is a company, late filing of accounts/annual returns

Rumours are however often unfounded, and can sometimes be spread maliciously. It is important not to inflame the situation or provoke actions which could give rise to difficulties for a company that did not previously exist. Continued success in business is dependent upon goodwill and confidence of being paid, and this can very quickly be eroded.

Where unfounded information is received, the first action should be to ascertain, as far as one is able from the company, whether the concerns are genuine. The information obtained may, however, be limited and difficulties played down for the very reasons described above.

A list should be obtained of all works, either at tender stage, in progress, within the defects period and/or recently completed by the company, and those involved in management of each of the projects given a gentle warning to be cautious, but not to delay or withhold payment, until more positive information is forthcoming. Also, not to inflame the situation by releasing the unfounded rumours to others.

7. **Confirmation of Insolvency**

Clear evidence that an insolvency situation exists usually occurs through information from a fairly reliable source, or alternatively when works on site suddenly stop and the labour force withdraw.

Checklist to assist in establishing if there is a right to terminate building contract for insolvency

1. If the Contractor is part of a group of companies, check that the Contractor, rather than a related company, is insolvent.
2. Is the Contractor in fact "Insolvent" as defined in the building contract?
3. Ensure that termination is not unreasonable or vexatious.
4. In addition to termination for insolvency) is there also a common law

right to terminate e.g. for repudiatory breach (a breach of contract that gives the aggrieved party the right to choose to end the contract or affirm the contract and claim damages). If so, the Council should exercise all termination rights i.e. termination should be on both grounds.

Note that if the Council terminates a contract when there is no contractual or common law right to do so, the Council may put itself in repudiatory breach.

At this stage, it is vitally important that urgent action is taken to ensure that the Council's interests are protected, and with the likelihood that there will be more than one project with an unresolved situation between the company and the Council (i.e. tenders, tender lists, schemes in progress or under defects, final retention monies outstanding), that a person with knowledge of insolvency issues acts as a co-ordinator in all of the actions taken, is the focal point for consultations with the receiver/liquidator and the Chief Monitoring Officer, and uses the right of set-off available under insolvency law (the right to off-set monies owing on one or more contracts to pay for costs incurred by reason of the insolvency situation on other contracts with the company) to the best advantage of the Council. A final auditable financial reconciliation statement over all contracts will eventually be required in which monies owing or due overall to either party will need to be prepared for presentation to the receiver/liquidator.

Until this overall financial situation can be established with confidence, all payment to the company on any of the outstanding contracts should be withheld.

8. **Important First Actions**

The following actions are to be carried out by a representative of Strategic Planning & Place in consultation with relevant consultants:

Arrange an immediate stop on all payments (in whatever stage).

Obtain a list of all projects or tender lists with the company.

Seek confirmation of the insolvency position with the company via one of the Directors if possible (not always easy as the company's phone often remains unanswered) or indirectly through other lines of communication via major sub-contractors, and obtain the name, address and telephone number of the person or persons appointed to oversee the insolvency affairs.

Notify the position to in-house and external personnel responsible for the management of each project.

The Council should contact the Contractor's Insolvency Practitioner to establish if the Insolvency Practitioner can confirm his intentions regarding the building contract – in certain circumstances the Contractor may still be able to complete the contract if the Insolvency Practitioner agrees and the Council waives its right to terminate the contract.

For works in progress, ensure that an immediate site and materials audit is carried out, and that the site is made weather-tight and suitably secured to prevent the removal of unfixed materials and any remaining plant. (Ownership of plant can be clarified subsequently; normally the Council can have the beneficial use of unfixed materials to complete the works, but again any legal challenges relating to ownership can be pursued subsequently.) Beware of sub-contractors whose payment will cease, removing materials or other goods from site to minimise their loss, often without any legal entitlement.

Ensure that any agreements with third parties are in place e.g. collateral warranties.

Check if the Council has rights over design and copyright. Obtain copies of any

documents/drawings that are not already in the Council's possession.

Check that the Council has all records necessary to comply with its statutory obligations e.g. Construction (Design and Management) Regulations 2015, building regulations etc.

Arrange for a questionnaire to be completed on each project confirming the current status of the scheme both with regard to the works/defects, etc, and the finances using Form E557.

Where necessary, measures must be taken to properly close the site down to ensure the safety of both authorised and unauthorised visitors, until normal site operations resume.

[Form E557](#)

9. Subsequent Actions

The following actions are to be carried out by a representative of Strategic Planning & Place in consultation with relevant consultants:

Prepare a schedule to summarise the overall position, and obtain a preliminary view as to the precise amount already paid to the Contractor and whether the Council is owed money, or has sufficient monies withheld to resolve outstanding issues.

Consult with the Chief Monitoring Officer and arrange, where appropriate, for a claim to be submitted and the Council recorded as an unsecured creditor, and on schemes subject to a Performance Bond, that the bondsman is notified of the insolvency position on projects subject to a Performance Bond. If security is in the form of a parent company guarantee, contact the parent company to arrange for the contract to be completed.

Eventually, following formalisation of the receivership/liquidation, a letter will be received from the receiver/liquidator confirming the company's status, and the date from which it formally applied.

A request will also be received for the payment of outstanding monies on each contract, with amounts taken from the contractor's files and employee consultations. These amounts may differ from the Council's own records and will include unaccepted claims or other disputed amounts.

At this stage too, decisions will have to be made as to the best method of completing outstanding works. Usual options are:-

Note: IP = Insolvency Practitioner

1. Novation of the current contract by arrangement with the IP.
2. Appointment of another contractor.
3. IP to arrange direct for the works to be completed.

10. Novation

The principle is that a substitute contractor takes the precise contractual position as the insolvent contractor had. It is a tripartite agreement; Employer, New Contractor, Insolvency Practitioner.

In fact, bargaining takes place and certain obligations are modified, i.e. resolution of defects in insolvent contractors work.

The IP will be looking for a payment from the new contractor for work done by insolvent contractor since last payment to him.

If conditions suitable – go for it. Through a certain amount of negotiating is

required at the time of set up. The contract once placed proceeds normally, unless the new contractor becomes insolvent.

Establish lines of communication with sub-contractors, suppliers etc. – check if they would be willing to continue working directly for a replacement contractor.

Are there any of the Contractor's personnel who are key to the project? If so, consider employing them to complete the contract.

11. **Another Contractor**

If cost rather than time is prime objective, then completion by re-tendering is the way forward. Always keep the receiver/liquidator informed of the actions proposed/being taken. If time is paramount then negotiation with the initial second lowest tenderer may be suitable, subject to necessary observance of standing orders.

12. **IP to Arrange Completion Direct**

Not usual. If work is near the end or in defects and monies are due to the contractor, which is not required for set-off against costs incurred on other contracts, then it could be advantageous. IP will probably want early payment to fund works. Employer's disadvantage is that defects will lie against insolvent contractor.

13. **Generally**

The following actions are to be carried out by a representative of Strategic Planning & Place in consultation with relevant consultants:

Ask Insolvency Practitioner if they have any proposals to put forward.

Keep detailed records.

Consider what is in County's best interests and which action will be most likely to mitigate loss, which is a legal requirement, and can be challenged.

Send provisional schedule to IP to commence process of settling accounts overall.

Leave to those responsible to settle their individual contracts, but answer any questions they may have and liaise generally with the IP.

As accounts are agreed with IP and audited, enter amounts on schedule and also any contra-charges for work and professional fees.

Contra-charges for work and fees can be dealt with in final account for each project. Make sure those responsible have all the information. When all accounts entered on schedule, send schedule to IP for agreement. When agreed, arrange for any balancing payment that remains to be made.

If the Council is in a loss situation overall, then send schedule to Chief Monitoring Officer, in order that the debt can be pursued in the form of a claim as an unsecured creditor.

Another point that will need to be resolved at an appropriate stage, where dispute exists, is the title of materials/plant on site.

14. **Creditor Ranking in Insolvency Settlements**

1. Fixed charge holders
2. Preferential creditors

Inland Revenue
Customs and Excise
Employees
3. Floating charge holders
4. Unsecured creditors

CONCLUSION