

MAIN CONTRACTOR INSOLVENCY November 2010

Sub-Contractor Rights when the Main Contractor becomes insolvent

The Office of National Statistics (ONS) shocked the industry last month by announcing that construction output was growing and thus the downturn was at an end. This news was soon followed on Monday 8th November 2010 by the sobering announcement that the national contractor ROK had entered into administration. As the depressed economic conditions continue, despite what the ONS may report, it is well worth considering what rights Sub-Contractors have when the Main Contractor becomes insolvent.

Administration

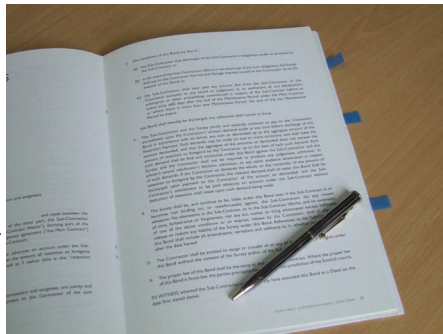
The main objective of administration is to attempt to save the company, often whilst a suitable buyer is sought. However, even in the current depressed market, few Sub-Contractors can risk continuing their contractual relations with an insolvent Main Contractor through fear of only recovering a percentage of what otherwise would be due should the administrators fail to save the company. It should also be noted that once a company has entered into administration creditors are prevented from commencing action such as adjudication or litigation to recover any claims. In some circumstances, where the Sub-Contractor's works are critical to the company in administration, it may be possible to secure payment from the Administrators for both completed and future works; hence the works could be completed with the risk considerably reduced.

It is therefore submitted that in most instances Sub-Contractors who encounter an insolvent Main Contractor should look to minimise their liability by terminating the Sub-

Contract. We consider below the Sub-Contractors' rights to terminate in relation to the JCT 2005 Standard Building Sub-Contract Conditions (SBCSub/C) and the NEC3 Engineering and Construction Subcontract.

JCT 2005 Standard Building Sub-Contract Conditions (SBCSub/C)

The JCT Sub-Contract Conditions provide a meaning of insolvency at clause 7.1, this includes at clause 7.1.4



the scenario where the Contractor *'...has appointed to him an administrator or administrative receiver'*.

Clause 7.10 of the JCT Sub-Contract Conditions provides that the Sub-Contractor is entitled to terminate its employment under the Sub-Contract if the Contractor *'...is insolvent or makes any proposal, gives notice of any meeting or becomes the subject of any proceedings relating to any of the matters referred to in clause 7.1.'*

The consequences of termination under clause 7.10 of the JCT Sub-Contract Conditions are set out at clause 7.11. The provisions therein apply in place of all other provisions within the Sub-Contract in relation to further payment and the release of any Retention.

Clause 7.11.3 requires the Sub-Contractor to provide an account to the Contractor following termination setting out the amounts of the

following:

- 1) the total value of work properly executed at the date of termination of the Sub-Contractor's employment;
- 2) any sums ascertained in respect of loss and expense (whether ascertained before or after the date of termination);
- 3) the reasonable cost of removal of plant and equipment from site;
- 4) the cost of goods and materials ordered for the Sub-Contract Works for which the Sub-Contractor has paid or is legally bound to pay, and;
- 5) any direct loss and/or damage caused to the Sub-Contractor by the termination.

The Contractor is required to pay the amounts properly due in accordance with the account within 28 days of receipt of it from the Sub-Contractor. Such payment is to be without deduction of any Retention.

NEC3 Engineering and Construction Subcontract

The NEC3 Engineering and Construction Subcontract provides that the Subcontractor may only terminate its obligation to provide the Subcontract Works for a reason identified in the Termination Table included at clause 90.2. Such reasons include where the Contractor become insolvent and are detailed at clause 91.1 (reasons R1 to R10). For example Reason R8 is where the Contractor has had an administration order made against it.

In the event that the Subcontractor terminates due to one of the reasons set out at clause 91.1 the Contractor may complete the Subcontract Works whilst the Subcontractor leaves the Working Area and removes the Equipment

pursuant to clause 92.2.

Clause 93 provides for payment on termination. Where the termination is resultant of one of the reasons set out at clause 91.1 the amount due on termination includes:

- an amount due as assessed for normal payments,
- the Defined Cost or Plant and Materials
 - within the Working Areas or
 - to which the Contractor has title and of which the Subcontractor has accepted delivery,
- other Defined Cost reasonably incurred in expectation of completing the whole of the subcontract works,
- any amounts retained by the Contractor and
- a deduction of any un-repaid balance of an advanced payment.

Hence the amount due under the NEC3 Engineering and Construction Subcontract is similar to that established under the JCT Subcontract. The reference to amounts retained by the Contractor includes amounts retained in respect of Retention.

Clause 93.2 also provides that where the main Option is A, B, C or D a further amount is due in respect of the sum resultant of the direct fee percentage applied to the excess of the total of the Prices at the Subcontract Date over the Price for Work Done to Date. This effectively compensates the Subcontractor for the loss of overhead and profit which would have

been recovered had the Subcontract not been terminated.

It is however of note that pursuant to clause 90.4 the Contractor has fourteen weeks within which to certify the final payment to the Subcontractor following termination and a further four weeks within which to make



payment. Hence the final payment may not be made until eighteen weeks after termination; an anxious period when it is considered why the Subcontract obligations were terminated.

Retention

The termination clauses within the JCT and NEC Subcontracts reviewed above apply equally where the Works have achieved practical completion.

This is of particular note in respect of retentions.

Since amounts retained as retentions are released in full on termination Sub-Contractors should consider terminating in order to recover retentions from an insolvent Main Contractor. Typically a Sub-Contractor who has completed £1m of work for a Main Contractor could have up to £25,000 held as retention in respect of completed projects. In the current climate such a sum may reflect the entire profit for those projects and hence is far too valuable to ignore.

Conclusion

There are of course usually warning signs that a Main Contractor may be in financial difficulty; hence action to limit exposure can often be taken prior to the right to terminate arising.

One such warning sign is late payment. All contractors have a statutory right to suspend performance of their obligations whilst payments remain outstanding. Such suspension will limit liability and in most forms of contract can be another reason for terminating should the payments remain outstanding for a prescribed period.

There is however a significant risk that some losses will be incurred when a Main Contractor becomes insolvent. It is therefore essential that Sub-Contractors look to limit their liability to Main Contractors in the current financial climate.

Haleys provide In-house training on all aspects of the JCT & NEC suites of contracts, for further details of these and other services Haleys can provide or to discuss this article please contact us at the following;

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