

Group Briefing

April 2018

Carillion: A collapse in time...? Dealing with the consequences of insolvency

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Can we learn sufficient lessons from Carillion to avoid construction related insolvency closer to home?

1. PUTTING INSOLVENCY ON THE AGENDA

The fallout from the collapse of Carillion, the diversified construction firm, continues to be felt here in Ireland. Despite assurance from the government that the direct impact on the public purse is minimal, the reality is that insolvency in the construction industry has a much wider impact than that immediately felt and the Carillion story is a timely reminder that even in “good times”, solvency should be top of the agenda for all stakeholders in a construction project.

2. PROCURING THE PROJECT

Any discussion of Carillion ultimately returns to the same question - how could a firm with so many high profile “lucrative” contracts, collapse so spectacularly? Surely in Ireland, where our fragile construction industry is only just recovering from its own lost decade, such doom and gloom is behind us?

The reality is, the rising market has not lifted all boats. Outside Dublin, recovery remains slow with competition for work fierce. Even within Dublin, procurement strategies often mean that behind a marquee prime development may lie a contractor working to very tight margins

and limited cash flow. While fixed price contracts, particularly when priced low, can be very attractive to an employer from a cost certainty perspective, it may not be an appropriate method of procuring a particular project and placing tight parameters on a contractor in a competitive tendering process can result in cost overruns and significant claims or cash flow issues.

3. MANAGING CASH FLOW & PAYMENTS

Care also needs to be taken to ensure that risks (including cash flow) sit with the party best placed to manage them. Similarly when bidding for work, contractors and subcontractors need to bid sensibly to avoid commencing work on a project for a price at which it cannot be completed.

The requirements of the Construction Contracts Act 2013 can, if not managed at main contract level, tighten the noose on already stretched contractors. A contractor should aim to secure appropriate payment terms which do not leave him effectively financing a project.

4. DO YOUR DILIGENCE

Regardless of the role a party is taking

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on a project, the robustness of the contractor/employer and its ability to resource the project is paramount and due diligence

should always be carried out before entering into a contract or commencing works. While certain forms of performance security can be put in place (see below), these should not be seen as a substitute for carrying out a certain level of due diligence on contractor or employer. If there is any doubt, and particularly on high value contracts, both employer and contractor should consider requesting a parent company guarantee (if available). Equally, the option of seeking an advance payment for large orders or significant design work, should be considered by a sub-contractor.

5. INSURANCE/BONDS

There are a number of bonds which can be sought to provide an extra level of comfort on a project including performance bonds and advance payment bonds. For a large project, and particularly where there is a funder involved, a performance bond will be required. While on demand bonds may be preferable, on-demand performance bonds are not generally available in the Irish market. Bonding at sub-contractor level is also becoming increasingly common – particularly where large advance payments are being made.

Insurances are also very important on any construction project, large or small. It is prudent to ensure that appropriate insurances are taken out to match the risk profile of the project and employers and contractors should seek certainty that the monies will be available to cover the cost of any remedial works. Contractors often face a difficulty where sub-contractors won't go back-to-back on professional indemnity requirements so all parties need to be vigilant as to how any gaps are managed.

6. DURING THE PROJECT

Despite the best intentions, solvency issues can often creep unexpectedly during the life of the project. The average construction contract will contain provisions dealing with insolvency which will often allow for termination on insolvency. From a contractor's perspective, these clauses can often work one way only i.e. the employer can terminate for insolvency whereas the contractor can terminate only for non-payment (if at all) which could mean the contractor has to wait until non-payment has occurred before terminating.

Regular payment flow from employer down to the lowest tier of sub-contractor is the best means of reducing the impact of insolvency. Employers may agree to reduce payment cycles to alleviate pressure on the main contractor who must comply with the Construction Contracts Act. If that is the case, the employer should ensure that this payment is actually flowing down to sub-contractors and contracts should provide for evidence that these payments are being made.

Regardless of insolvency, the Construction Contracts Act provides for suspension of works for non-payment. While this is a very powerful tool at the disposal of sub-contractors where payment is not flowing down as it should, it should only be utilised in very clear cases of non-payment. This is because an unjustified suspension will leave the suspending party liable for delay and open to a claim for compensation and damages for any loss caused by the suspension.

7. RETENTION OF TITLE

A retention of title provision in a contract can be a powerful tool for a contractor or subcontractor where payment for goods has not been made. In essence, retention of title allows the seller of goods to retain title in those goods until certain conditions have

been met (e.g. payment). This allows the seller of goods priority over secured creditors of the buyer, where the buyer is insolvent. Retention of title should not be seen as a replacement for more robust forms of security such as bonds or timely payment provisions.

8. STEP IN

In the event of main contractor insolvency, the employer will wish to retain the momentum of the project through the services of suppliers and subcontractors who have contracted with the insolvent contractor. Where the employer has collateral warranties with the principal subcontractors, these usually include a provision whereby the employer can step into the main contractor's shoes allowing subcontract works to proceed and ensuring that the employer has recourse to the subcontractor in respect of future defects. Certain forms of contract and amended forms will allow the employer to pay subcontractors and suppliers directly.

It is also important to consider the rights that other parties may have where insolvency issues arise. Typically on funded projects, a funder may have a right of step-in (through a collateral warranty or similar deed executed in their favour) over a contract or sub-contract.

CONCLUSION

It goes without saying that each party to a construction contract should carefully diligence the entity with whom they are contracting. This step should be updated at regular intervals throughout the project. Entering into contracts with a balanced risk profile and sustainable payment terms can often mitigate problems at the back end of a project. Prevention is better than cure but protections will still need to be built in to the contracts by way of payment and performance security, insurances and collateral warranties.

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