



In the Blue Corner
Construction Law: in the
Red Corner Insolvency
Law – working through the
clash

RICHARD WILLIAMS

Construction Law v Insolvency Law

- Construction Law
 - Based on contract and tort law and some statute
 - protection of parties' rights regarding payment and/or performance under the relevant contracts
 - innocent party to be compensated by the defaulting party
 - not concerned with collective rights of creditors
 - HGCRA all geared towards swift payment without regard to other parties

Construction law v Insolvency Law

- **Insolvency Law**
 - derived from the law of trust and, to some extent, property and now has its base in statute within the Insolvency Act 1986 and the Insolvency Rules 2016
 - orderly realisation of the insolvent party's assets
 - distribution of the proceeds to creditors in accordance with their rights – the statutory scheme

Which prevails when a business goes into insolvency?

What will be covered

- Termination
- Payment Collection Rights and Issues
- Collection of Retention in Insolvency
- Set-Off in Insolvency
- Retention of Title in construction
- Adjudication in Insolvency and Enforcement
- Use of statutory demand and winding up-petitions to collect construction debts

Termination

- Virtually all construction contracts are terminated on insolvency
 - Under contract
 - Under common law – for repudiatory breach – a party evidences an intention not to be bound by contract
 - By novation – a novation agreement brings to an end the relationship between the original contracting party (except to the extent preserved), and replaces it.

Most terminations on insolvency happen under the Contract: insolvency moratoria under UK law do not prevent it

Termination on insolvency – cont.

- Insolvency is not automatically a repudiatory breach of contract at common law
- Express provision are required, for example:
- JCT Sub-contract 2016 cl. 7.1 & 7.5
 - long and detailed definition of “Insolvency”
 - automatic suspension of sub-contract works is coupled with a right for the Contractor to serve notice of termination at any time

Consequences of Termination

- Contractor may employ and pay others to complete Works
- Contractor may take possession of Works and use temporary buildings and plant and equipment
- Sub-Contractor must remove temporary buildings and plant and equipment if required
- Sub-Contractor must give Contractor copies of Design Documents

Suspension of payment on termination

- Requirements for further payment or release of retention cease to apply but only insofar as:
 - a Pay Less Notice has been given or
 - Sub-Contractor has become Insolvent after last date for service of Pay Less Notice (so that no PLN can be served)
- Insolvent is defined in the HGCR: some sub-contracts extend the term to include pre insolvency events: this does not work
- The trigger is occurrence of insolvency not notification

Termination Account – Works Completed

- Sub-Contractor may apply for value of works executed/goods supplied on completion of the Works and making good of defects or termination of main Contract (7.7.4) – likely to be years away
- Contractor may deduct direct loss and damage and amounts payable to Contractor under Sub-Contract
- If the figure is negative – a debt is due from Sub-Contractor

Termination procedure NEC

- NEC3 contract cl. 9 utilises a Termination Table
- Table sets out various reasons for termination (including insolvency and default), the procedure for each and the amount due for each
- Procedures/arrangements are similar to JCT
- Amount due on termination assessed by Project Manager within 13 weeks and includes a deduction of the forecast of the additional cost of completing the whole of the sub-contract works
- Timing better for insolvent payee but less certain in amounts

To terminate or not?

- What are the likely factors influencing the Main Contractor's decision whether to terminate?
- Complexity and state of completion of sub-contract works
- Ease of replacing sub-contractor with substitute
- Availability of key components, materials etc
- Drift of staff and labour

To terminate or not? Cont.

- Speed is a vital factor: who is best placed to complete the works the quickest?
- The payments position is important: the less exposed the paying party is at the point of insolvency the more likely they are to terminate: this includes collection from bonds and guarantees which can incentivise termination
- Bargaining position after Insolvency is perhaps the key factor: an IP of a bespoke engineering manufacturer is likely to be in a better position than one of a ground works contractor

Retention Collection

- Withheld from payments: held on trust (if set aside) and released as to 50% on Practical Completion and 50% on Certificate of Making Good Defects
- Typically 5% of the sum paid under each Interim Certificate
- The second tranche of retention is a valuable asset for the IP assuming there are no defects in the works
- The “lack of warranties” issue – some forms of sub-contract say that the second tranche of retention may be withheld permanently/ until latent defects warranty ends
- Anti deprivation- what amounts to a legal right to withhold retention for a prolonged period following insolvency?

Issues for IPs in face of Termination

- excess completion costs can be recovered
- costs of rectification can be recovered
- professional fees can be recovered
- lack of warranties will be an issue as the replacement contractor will increase price to cover risks
- inability to pursue claims/counterclaims from a practical perspective will be known: records may be poor and witnesses unwilling
- set-off can be applied across contracts
- security for costs will be an issue in proceedings and adjudication unlikely to be fruitful in formal insolvency

Blockers to Collection – Set-Off

- Set-off is a key factor in construction and can and does operate across contracts where the parties are the same: many sub-contractors will have several contracts with the same contractor
- An unprofitable contract can lead to inability to collect money from a profitable one

Blockers to Collection - Set-Off

- Legal Set-Off – liquidated debts and cross debts
- Equitable Set-Off – sufficiently closely connected
- Contractual Set-Off – expressed in contracts
- Liquidation Set-Off – mandatory on liquidation of all mutual dealings
- Administration Set-Off – mandatory after notice of distribution

Any one or more can apply to a construction situation: see *Hargreaves v Action 2000* [1993] B.C.LC 1111

Blockers to Collection - Retention of Title

- A common erosion/blocker is where a contractor has paid (or has not paid) the sub-contractor for materials but the sub-contractor has not paid the supplier
- The supplier claims ROT and the contractor has to pay the supplier and then claims this in the termination account
- It is in the IP's interests to challenge ROT rights and work together with the Contractor to defeat such claim

Retention of title

- Fixed materials cease to be chattels and become part of the land – ‘quicquid plantatur’ rule
- Burden of proof rests on supplier: *L Holland v Hodgson* (1872)
- Unfixed goods - S. 25 Sale of Goods Act 1979 – where materials are provided pursuant to a contract for the sale of goods and the goods are paid for by employer in good faith and without notice of ROT rights following a “disposition” title passes
- Payment of a certified sum is a disposition (*Archivent v Strathclyde General Council* (1984))

S.25 - the simple guide

- Protection where you have paid someone but they have not paid someone down the chain in consequence of which ROT rights are claimed by that person
- What is the underlying contract where the ROT clause applies – sale of goods or supply and fix? Must be sale of goods
- The status of the other contracts is not relevant
- Does your contract contain a clause providing for title to pass on the goods being on site and paid for?
- Have you paid for the goods at a time when you had no notice of the ROT right in the underlying contract?

Adjudication v. Insolvency: Introduction

- Adjudication:
 - A statutory process whereby a temporary decision is reached to resolve a dispute on a “quick and dirty” basis
 - 28 day process normally without a hearing
 - Binding until proceedings determine the matter
 - Enforced via summary judgment
- Insolvency: concerned with the equal treatment of creditors on a “pari passu” basis

Which prevails?

Effect of Insolvency on Adjudication

- Adjudication is a “proceeding” within Insolvency Act so the moratorium applies
- *A Straume (UK) Ltd v. Bradlor Developments*: Leave for cross adjudication sought: employer had not served pay less notice
- Leave was refused on the basis that it duplicated the defence and was being put forward for a collateral purpose

Iverson Road v South Coast Construction [2017] EWHC 61 (TCC)

- SC obtained a decision in November 2016
- SC applied for summary judgment and IR contested
- IR filed Nols for administration on 29 November 2016, 13 December 2016, and 4 January 2017
- Hearing took place on 18 January 2017 : IR only informed SC of Nol on 16 January 2017
- Court would have given permission for enforcement proceedings to continue but for liquidation between hearing and judgment
- May mean that an interim moratorium may not be enough to prevent enforcement at least up to judgment

Adjudication v Insolvency Set-Off

- Mandatory Insolvency set-off applies on liquidation and bankruptcy
- Mutual credits, mutual debts, and other mutual dealings have to be brought into account
- An account is taken and the balance is provable or payable to the liquidator/trustee (as the case may be)

Insolvency Set-Off - adjudications by insolvent companies

- Where the claimant is in liquidation, the court will not grant summary judgment where a cross claim which might qualify for set-off is asserted (*Bouyges v. Dahl-Jensen (2000)*)
- Adjudication is unlikely to be available to pursue any net balance where insolvency set off applies (*Enterprise Managed Services v. Tony McFadden (2009)*)

Stays of enforcement and insolvency arguments

- Adjudication is an interim process: arguments revolve around the granting of a stay because of claimant's inability to repay
- If money is paid out to an insolvent applicant then
- The general rule is that enforcement of a judgment should be allowed in the absence of special circumstances
- The burden of proof is on the party seeking stay (*Farrelly v. Byrne Brothers (2013)*)
- Plethora of case law – each decided on its own facts

Stay of enforcement

- The early skirmishes
 - Receivership was considered a special circumstance and a stay granted: *Rainford House v. Cadogan (2001)*
 - Where there are unproven allegations of insolvency the position was less certain: see *SL Timber Systems v. Carillion (2001)*
- *Wimbledon Construction v. Vago (2005)* is the lead case
- The claimant should not generally be kept out of his money

Stay of enforcement (2)

- Probable inability to repay may constitute special circumstances rendering it appropriate to grant stay
- If the claimant is in insolvent liquidation, or there is no dispute on evidence of insolvent, a stay will be usual
- Even if evidence suggests probability of inability to repay, that evidence would not usually justify a stay if:
 - the claimant's financial position is the same or similar as at time of the contract, or
 - The claimant's financial position is due either wholly or in significant part due to defendant's failure to pay sums that were awarded

Statutory demands and winding up petitions

- A statutory demand can be served by any creditor owed in excess of £750 requiring a company to pay the sum due: contents are prescribed by the Insolvency Rules
- If the company has for 3 weeks neglected to pay the sum or secure or compound for it to the reasonable satisfaction of the creditor the company is deemed unable to pay its debts and this constitutes grounds for winding up
- Statutory demands are often used tactically to explore whether there is any arguable defence to a claim without significant risk of costs.
- The company will be forced to defend its position and to seek withdrawal of the demand
- The company's ultimate remedy is to seek an injunction to restrain the issue of a winding up petition

Winding up Petitions

- It is not necessary to serve a statutory demand first
- A debt which is undisputed and not paid can found a petition: a simple demand for payment and of intention to issue will suffice
- The remedy is an injunction to restrain issue or, where, issued to restrain advertisement coupled with an application to strike out as an abuse of process
- The debt must be disputed on bona fide and substantial grounds
- Where the existence of cross claims is alleged the court has a discretion as to whether to bring these into account
- The existence of the petition is a matter of public record and can have serious repercussions for a company

Winding up petitions

- Upon its issue a hearing date is fixed which is normally 6-8 weeks after issue
- The petition is served on the company
- Notice of the petition is advertised in the Gazette not less than 7 business days after service
- A notice in the Gazette is likely to lead to the company's bank account being frozen
- At the hearing the court can make a winding up order and the Official Receiver becomes the liquidator

Insolvency Proceedings following adjudication

- An injunction was refused in *Guardi Shoes v. Datum (2001)*: the Court said the cross-claim was an issue for the petition hearing: the creditor had obtained judgment on the decision and the debtor had not adjudicated its cross-claim
- A petition was struck out where there was a dispute on the adjudicator's jurisdiction (*Towsey v. Highgrove Homes (2013)*)
- A failure to litigate/adjudicate a cross claim is not critical but may be relevant (*Shaw v. MFP Foundations & Piling (2010)*)

Petition with no adjudication

Wilson and Sharp Investments Limited v Harbour View Developments Ltd [2015] EWCA Civ 1030

- Four interim payment certificates were issued in August/September 2013. No pay less notices served
- Contract terminated at law in January 2014
- Winding up petition threatened in February 2014 if payment not made by April
- Cross claims were raised and an injunction application issued in April
- Further cross claims alleged in July 2014 and the Contractor convened a creditors' meeting under s.98

Petition with no adjudication

- Contract contained a suspension of payment clause.
- The judge said that this could not be relied upon where the termination occurred before the insolvency
- The Court of Appeal disagreed and said that the Appellant had a genuine dispute as to whether it could still rely on the suspension of payment right
- The Court of Appeal also said that the crossclaims gave rise to a genuine dispute
- Case illustrates the court will be very slow to allow a petition on a failure to serve a pay less notice if claimant is insolvent

Petition with no adjudication

COD Hyde Ltd v Space Change Management Ltd [2016]
EWHC 820 (Ch)

- The Employer did not pay and the Contractor validly suspended and then terminated the Contract for non payment
- It served statutory demands for non payment and the Employer sought an injunction
- The application was refused on the basis that the Employer's arguments regarding the right to terminate and its cross claims were "not even shadowy"

Petition with no adjudication

Cosmur Construction (London) Ltd v St Lewis Design Ltd
[2016] EWHC 2678 (Ch)

- The Contractor failed to serve a pay less notice
- There was a genuine dispute as to whether the application complied with the terms and conditions that were arguably applicable
- The Contractor also had arguable set-offs and counterclaims

Petition with no adjudication

Breyer Group Plc v RBK Engineering Ltd [2017] EWHC 1206 (Ch)

- It was argued that a payment notice was late and that the application had become the amount due.
- The court granted an injunction on the basis that there was a dispute as to whether the notice had been served in time, there were arguable cross claims, and the company was clearly solvent
- The court also did not accept that even if the payment notice had not been served in time that would automatically mean a debt arose for the whole sum applied for

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