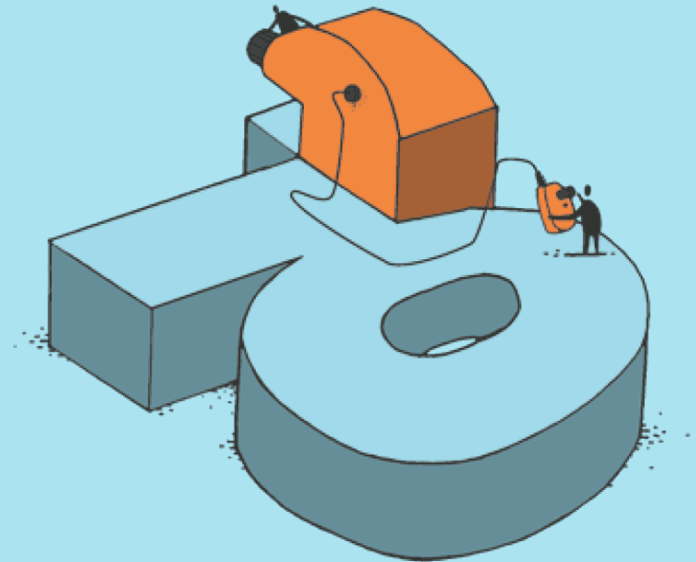


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Tenon recovery

What is Insolvency?

- Types of Corporate Insolvency
- Insolvency in the Chain
- Practical Steps

Insolvency in the Construction Chain

Firstly What is Insolvency?

Definition – A Company is insolvent either on a balance sheet basis i.e. its assets are less than its liabilities or as a result of its inability to pay its debts as they fall due.

Types of Corporate Insolvency

- > Company Voluntary Arrangements “CVA”
- > Administration
- > Liquidation

Company Voluntary Arrangement “CVA”

- > Basically a formalised contract between a Company and its creditors that must be approved by a majority in excess of 75% in value of creditors who bother to vote.
- > Normally the Company will continue to trade under the control of its directors. A Supervisor (a Licensed Insolvency Practitioner) will ensure that it maintains its obligations under the arrangement.
- > Construction CVA's will often be drafted that the insolvent Company will continue to pursue funds under a contractual claim and the net funds (after legal fees etc) are made available for creditors together with a contribution from future profits, whilst other debtor receipts are used to fund the ongoing business.

Company Voluntary Arrangement “CVA”

Continued...

Benefits of a CVA

- > Creditors may receive some monies by supporting the company which can finish projects. Payment may be deferred, but is better than receiving nothing at all.
- > In most CVA's all unsecured creditors should be treated equally, it is possible that essential suppliers could receive preferential terms if this is disclosed in the CVA proposals.
- > In a recent case (Mead General Building Ltd in CVA V Dartmoor Properties), it was held that a CVA would not automatically entitle a defendant to a stay of execution on enforcement of adjudication. The facts of the case was that Mead's insolvency was caused by Dartmoors' failure to pay and that Mead could continue with the support of its creditors to trade out of difficulties. Consequently Mead could repay any part of the judgment if in a subsequent arbitration the arbitrator concluded that Mead had been overpaid.
- > A CVA does not constitute insolvency within the terms of Section 113 of the Housing Grants, Construction and Regeneration Act 1996 i.e. a paid when paid clause cannot be operated on the basis of insolvency further up the employment chain.

Company Voluntary Arrangement “CVA”

Continued...

Disadvantages of a CVA

Although a Company can continue to trade after a CVA, many suppliers will no longer give credit – therefore cashflow problems may continue to restrict the ongoing business.

Administration

- > An Administrator is appointed by a Bank, the Directors or occasionally a major creditor. The Administrator will take full control of the Company. Even before an Administrator is appointed a Notice of Intention to Appoint an Administrator (filed at Court) will protect the Company from any legal process commenced by its creditors (winding up, distraint etc).
- > An Administrator may seek an immediate sale or may continue to trade either for a short period (e.g. to finish nearly completed contracts) or for a long period possibly allowing the Company to exit administration via a CVA.
- > Debtors and creditors will therefore have to deal with the Administrator rather than the Directors although the Administrator may take advice from the Directors and senior employees. An Administrator will seek to maximise a Company's assets by undertaking whatever deals he believes will be beneficial.

Liquidation

- > A Liquidation occurs when a Company is wound up by the Court following service of a winding up petition or when a meeting of creditors is called and a liquidator is appointed by the majority in value of creditors attending and voting.
- > If a Company enters liquidation it is likely to cease trading and the Liquidator will merely go about collecting in and realising assets.
- > It is still possible that the Liquidator will agree to finish contract works but this may be done by engaging former employees or subcontractors.

Insolvency Practitioners Perspective / Timing

The Chain

D Developer (Assumed to be Bank funded owner of the site)

C Main Contractor

S Subcontractor

In the potential insolvency of D, C or S the Insolvency Practitioner involved will wish to maximise funds available to him, whilst minimising any risk.

Administration of the Developer

If appointed over the Developer he will want to ensure that if he is to continue to complete the site that: -

- > The value of the completed site at the date of completion less costs to completion (including monitoring costs and interest and insurance) is greater than the sale value of the site at the date of this appointment.

Assuming 1 to be correct, the Administrator may be funded by the Bank who has lent against the site and can either work with the existing contractor or seek a new contractor, this may be determined by: -

- > Can existing contractors be relied upon particularly as they have been weakened by the insolvency of the Developer.
- > Can the Contractor's subcontractors be relied upon if they have also suffered financial loss.

Administration of the Main Contractor

It may be possible for a struggling contractor to agree revised payment terms e.g. weekly or fortnightly although the Administrator is likely to want to see payments going into the hands of key subcontractors to ensure their commitment to the project.

If an Administrator is appointed to deal with insolvency of the contractor, his main considerations will be: -

- > What has caused the insolvency, if it has been brought about by a break down in relations with the Developer then it is unlikely that continuing on site is likely to benefit the Administration and hence there is unlikely to be a benefit in maintaining any ongoing relations with subcontractors as he will not be in a position to pay them. It is clear from the Melville Dundas case that if a contract is determined by the employer based on insolvency and the contract contains provision for set off the employer is not obliged to pay application for payment made prior to insolvency.

Administration of the Main Contractor

Continued...

Assuming that relations with the Developer are still good and issues such as warranties and retentions can be resolved if the contract is continued.

- > Is the amount likely to be earned (i.e. the monies due for completed works not paid and future works) substantially greater than the costs of completing works together with the costs of the Administrator running the contract.
- > What is the certainty of getting paid by the Developer. Is it possible to get the Developer's bankers to provide guarantees of payment in return for completion of works.
- > It is unlikely that the Administrator will be holding any funds hence can a deal be constructed that either allows: -
 - » Subcontractors to be paid when the Administrator receives his money.
 - » Payment being made direct to subcontractors with the balance being paid to the Administrator.

Administration of the Main Contractor

Continued...

- > What risk is there that action by subcontractors will sabotage efforts to complete the contract and lead to the Developer not paying.
- > Can a prepack deal be implemented in which a contract is novated either to a Phoenix company or parallel company with the consent of both the Developer and the subcontractors. In the alternative the contract could remain with the Company in administration who subcontracts the work to another entity which employs former employees and subcontractors.

Insolvency of Subcontractor

- > Much of the same considerations apply in the relationship between an insolvent subcontractor and main contractor.
- > Administrators are rightly distrustful of many main contractors who clearly see forcing a number of subcontractors into insolvency as a means to avoid payment.
- > Assuming a good relationship can be forged an Administrator may choose to complete or novate contracts subject to being assured of the net benefit for creditors.

Practical Steps

Signs of Insolvency

- > Be aware of impending insolvency – if activity on a site starts to slow, payments are made late and dubious disputes are raised these are not good signs. Review sales literature, if end user sales are not being made, funders may start to lose confidence and appoint
- > If you experience the above problems across several sites for one employer, this is a clear indicator that trouble may be ahead (or the employer is trying to force you into insolvency).

Practical Steps

Signs of Insolvency

Continued...

- > Act Quickly – Rapid action may be the difference between your own Company surviving or failing.
 - > Take legal advice to determine what you can and can't do without incurring penalties.
 - > Minimise surplus materials on site and negotiate payment in return for any future supply to site.
 - > Off hire/remove any surplus equipment from site.
 - > Try to get paid by Bank transfer, if not collect a cheque in person, if it bounces threaten to present an immediate winding up petition unless an immediate transfer of funds is made (a solicitor should be used).
 - > Try to be indispensable. A Bank may authorise a payment to you when no one else is likely to get one if you can justify why you are needed (a threat to remove scaffolding usually gets attention as does anything with health and safety ramifications).

Actions On Insolvency

Determine what form of insolvency is involved, if it is a Company Voluntary Arrangement it may be preferable to support it if gives the opportunity for recovery under contract further up the construction chain. Your vote will contribute towards the 75% approval needed. If it is a liquidation it is likely that all work will cease.

Actions On Insolvency

Continued...

Act Quickly

- > Get advice from an independent Insolvency Practitioner.
- > Contact the Insolvency Practitioner dealing with the insolvent company to determine if there is likely to be a beneficial way forward. Seeking a meeting within hours or at worst days, do not lose initiative.
- > Contact other affected parties, an Insolvency Practitioner would prefer to deal collectively than separately.
- > Bear in mind you may have to be constructive with payment terms e.g. paid when paid, consider how your cooperation will not only benefit yourself but will also generate funds for the insolvent estate – if it is only beneficial to you the Insolvency Practitioner will have no reason to assert.
- > Set out what makes you key to the project e.g. knowledge, provision of materials with long order times, health and safety issues, certificates, being key to a project, make it more likely that you can negotiate to recover arrears or at least get paid in the future.

Actions On Insolvency

Continued...

In any negotiations ensure that payments to you are classified as an expense of the Administration/Liquidation. An Insolvency Practitioner is obliged to distribute funds in a prescribed order set out by the Insolvency Act and Rules. By negotiating your costs as an expense they will rank above the Insolvency Practitioner's own fees and this will go a long way to ensure you get paid even if things go badly wrong in the insolvency.



Any Questions?