

## RICS Professional Guidance, UK

# Termination of contract, corporate recovery and insolvency

1st edition, guidance note



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RICS guidance note

1st edition (GN 104/2013)



Acknowledgment

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# Contents

<b>Acknowledgments</b>	<b>iv</b>
<b>RICS guidance notes</b>	<b>1</b>
<b>1 Introduction</b>	<b>3</b>
1.1 What is termination of contract in terms of a construction contract? .....	3
1.2 What is corporate recovery in terms of a construction company? .....	3
1.3 What is insolvency of a party in terms of a construction contract? .....	3
<b>2 General principles (Level 1 – Knowing)</b>	<b>4</b>
2.1 Termination of contract.....	4
2.2 Corporate recovery and insolvency.....	5
<b>3 Practical application (Level 2 – Doing)</b>	<b>10</b>
3.1 Termination of contract.....	10
3.2 Corporate recovery and insolvency.....	12
<b>4 Practical considerations (Level 3 – Doing/advising)</b>	<b>17</b>
4.1 Termination of contract.....	17
4.2 Corporate recovery and insolvency.....	19
<b>Appendices</b>	<b>25</b>
A Simple notional final account example .....	25
B Construction project risk assessment matrix.....	26

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This is a guidance note. Where recommendations are made for specific professional tasks, these are intended to represent 'best practice', i.e. recommendations which in the opinion of RICS meet a high standard of professional competence.

Although members are not required to follow the recommendations contained in the note, they should take into account the following points.

When an allegation of professional negligence is made against a surveyor, a court or tribunal may take account of the contents of any relevant guidance notes published by RICS in deciding whether or not the member had acted with reasonable competence.

In the opinion of RICS, a member conforming to the practices recommended in this note should have at least a partial defence to an allegation of negligence if they have followed those practices. However, members have the responsibility of deciding when it is inappropriate to follow the guidance.

It is for each member to decide on the appropriate procedure to follow in any professional task. However, where members do not comply with the practice recommended in this note, they should do so only for a good reason. In the event of a legal dispute, a court or tribunal may require them to explain why they decided not to adopt the recommended practice. Also, if members have not followed this guidance, and their actions are questioned in an RICS disciplinary case, they will be asked to explain the actions they did take and this may be taken into account by the Panel.

In addition, guidance notes are relevant to professional competence in that each member should be up to date and should have knowledge of guidance notes within a reasonable time of their coming into effect.

This guidance note is believed to reflect case law and legislation applicable at its date of publication. It is the member's responsibility to establish if any changes in case law or legislation after the publication date have an impact on the guidance or information in this document.

## Document status defined

RICS produces a range of professional guidance and standards products. These have been defined in the table below. This document is a guidance note.

Type of document	Definition	Status
<b>Standard</b>		
International Standard	An international high level principle based standard developed in collaboration with other relevant bodies	Mandatory
<b>Practice Statement</b>		
RICS practice statement	Document that provides members with mandatory requirements under Rule 4 of the Rules of Conduct for members	Mandatory
<b>Guidance</b>		
RICS Code of Practice	Document approved by RICS, and endorsed by another professional body/stakeholder that provides users with recommendations for accepted good practice as followed by conscientious practitioners	Mandatory or recommended good practice (will be confirmed in the document itself)
RICS Guidance Note (GN)	Document that provides users with recommendations for accepted good practice as followed by competent and conscientious practitioners	Recommended good practice
RICS Information Paper (IP)	Practice-based information that provides users with the latest information and/or research	Information and/or explanatory commentary

# 1 Introduction

This guidance note reviews the subject primarily from the perspective of a chartered surveyor for RICS with a commensurate level of specialism. It also deals with the main issues encountered in and associated with a construction project. Generally, the guidance note advises on the issues and also suggests when further specialist assistance may be required either legally or technically.

The guidance note will review the main types of insolvency and termination issues for generic contracts:

- the processes
- the parties to them
- their purpose and
- general terms.

At Level 1 (Knowing) general principles are discussed with the meanings of certain terms.

At Level 2 (Doing) practical applications are considered for the chartered surveyor.

At Level 3 (Doing/advising) practical considerations and issues may lead to the requirement for further reports, advice and appointments other than chartered surveyors, as well as other related topics covered by RICS guidance notes, such as bonds and guarantees.

## 1.1 What is termination of contract in terms of a construction contract?

Termination of a construction contract by one party to the contract can occur where the other party has breached the terms of the contract.

Most construction contracts contain provisions detailing how in such circumstances it may be terminated.

## 1.2 What is corporate recovery in terms of a construction company?

‘Corporate recovery’ is a term used to describe the process and actions taken to bring an ailing company back to full health; this can involve the provision of financial, restructuring, accounts and legal advice by those qualified to give such advice and the possible appointment of an insolvency practitioner.

## 1.3 What is insolvency of a party in terms of a construction contract?

A company or party is deemed to be insolvent when it does not have sufficient assets to cover its debts or is unable to pay its debts when they are due. A common indication that a company may be insolvent is that it consistently makes late payment to creditors (including HMRC). Also, the instigation of legal action against the company by a creditor to recover an unpaid sum of money is evidence that the company may be insolvent.

## 2 General principles (Level 1 – Knowing)

### 2.1 Termination of contract

#### 2.1.1 Good management/avoidance of potential problems

It is clearly preferable to avoid having to terminate a contract by discussing the issues causing the concern. This will avoid the expenditure of time, cost and expertise of appointing a new party.

With this in mind, the chartered surveyor can work to suggest possible actions to prevent termination. To do so, the chartered surveyor needs to be familiar with the terms of the contract and the obligations of both parties in respect of termination, and the subsequent consequences.

#### 2.1.2 What is a release agreement?

A release agreement is an agreement drawn up by the parties that, for the avoidance of doubt, lays down the terms of the termination of the contract. This provides a clean, unequivocal break for the parties. This is important especially if one or both parties are still solvent and wish to continue in their core businesses unaffected by the termination. It is prudent to check the contract and ensure that all of the duties and obligations have been performed, including financial recovery. Legal advice should be sought for such an agreement.

#### 2.1.3 What is a breach?

A breach of contract (or subcontract) is a failure by a party to the contract to comply with an obligation imposed on it under the terms of the contract. The types of breach and the consequences are discussed later in this guidance note under the practical application section (Level 2 – Doing). Some breaches of contract are minor and do not necessarily lead to circumstances whereby the aggrieved party has grounds to terminate the contract.

Breaches of construction contract by the contractor frequently involve defective work or works. For example, often a party fully performs their required work tasks but these contain defects. The consequence of such defects could be deemed to be a failure of the party to carry out their contractual obligations. In such a situation the defective work is usually covered by a parent company guarantee, or in a bond situation the additional cost of completing the works may include the cost of rectifying the defective works. This element is discussed in more detail in the RICS guidance note *Construction security and performance documents*.

#### 2.1.4 General termination provisions in construction contracts

Most construction contracts contain provision for termination, and the chartered surveyor should be aware of these in order that the potential for termination can be managed and/or acted upon. The termination may be voluntary or involuntary.

Voluntary termination is where the parties agree mutually to terminate or, alternatively, it can be when one party ends the contractual agreement.

Involuntary termination can be the consequence of insolvency (discussed in more detail in subsection 2.2) and will occur where a party does not have enough assets to cover its debts, or if the party is unable to pay its debts when they are due.

In either case the contract clauses must be followed closely and diligently by the chartered surveyor dealing with the termination since a wrongfully terminated contract can lead to repudiation (see paragraph 3.1.2.1). The contract should invariably describe the requirements for the serving of notice, setting out the default(s) and preferably the clause or

clauses in the contract relied upon. Without detailing each of the construction contracts, below is a brief checklist for ensuring the correct process is adhered to. Ultimately, a

chartered surveyor who does not have the relevant experience necessary should seek additional assistance, whether legal or technical.

#### **Checklist for termination of contract**

- 1 Discuss the situation with the employer/party
- 2 Make a note of all of the relevant contract clauses for the termination
- 3 Seek additional assistance from an expert if required
- 4 Write and serve a notice in accordance with the contract detailing the breach, ensuring correct postal delivery procedure
- 5 Assuming the breach continues, and after the requisite time period, dispatch the further notice (assuming the contract requires one), keeping to the facts and the contract clauses
- 6 Document preparation/final account information/site security/alternative contractor/party tenders

## 2.2 Corporate recovery and insolvency

### 2.2.1 Who can deal with construction insolvency?

RICS has published a regulation/insolvency information sheet (available at [www.rics.org/Global/Downloads/Insolvency\\_further\\_information\\_sheet.pdf](http://www.rics.org/Global/Downloads/Insolvency_further_information_sheet.pdf)) that offers advice on regulation issues and the recommended course of action for the chartered surveyor or chartered company. Another useful contact is the Insolvency Service ([www.bis.gov.uk/insolvency](http://www.bis.gov.uk/insolvency)), which is part of the Department for Business, Innovation & Skills and is an insolvency law and regulatory framework operating mainly under the following legislation:

- *Insolvency Acts* 1986 and 2000
- *Company Directors Disqualification Act* 1986
- *Employment Rights Act* 1996
- *Companies Acts* 1985 and 2006 and
- *Enterprise Act* 2002.

With regard to insolvency, all liquidators, supervisors, administrative receivers and administrators taking office after 29 December 1986 must be authorised insolvency practitioners. Companies House produces a document that provides information on the *Insolvency Act* 1986. Consequently, a chartered surveyor without such authorisation is unable to deal with construction insolvency.

### 2.2.2 Different types of insolvency for companies

There are five types of insolvency, namely:

- 1 company voluntary arrangements (CVAs)
- 2 administration
- 3 winding up of the party/company or compulsory liquidation
- 4 administrative receivership (or receivership) and
- 5 voluntary liquidation.

#### 2.2.2.1 CVAs

CVAs occur when a company is in difficulty financially but is not necessarily insolvent, although that may become the case as a consequence. They are usually commenced by the directors of the company.

The process involves the CVA being approved at a scheduled creditors meeting. The directors then put forward a person who is able to make a viable proposal to the creditors with a view to them being able to secure an acceptable percentage of the monies due to them. The nominee will be responsible for chairing the CVA process.

#### 2.2.2.2 Administration

Administration involves the adoption of a procedure that allows a company unable to pay its debts to continue to trade for a further period, during which its assets are protected. The intention is to achieve a good

market price for all or partial assets and/or to keep the company fully operational, as a 'rescue' function.

The advantage of this over involuntary liquidation is that the assets may realise a better position to that of an involuntary arrangement, and the administrator can wield full management powers to secure the best position for all creditors, not just the preferential ones. This hopefully negates the need for the winding up of the party.

Administration is normally instigated by the directors of the company and an unsecured creditor or a floating charge holder. The directors or creditor make an application to the court, or the floating charge holder (surety) appoints an administrator. The party then continues to trade while the administrator endeavours to realise the best price for the company's assets. The administrator is legally obliged to do so.

A little-used subcategory of administration is a 'pre-packaged insolvency', in which partial assets or the company itself are negotiated with a potential purchaser such as a 'newco' or existing directors. The administrator manages the sale immediately upon appointment.

#### *2.2.2.3 Winding up of the party/ company or compulsory liquidation*

Winding up of the party/company or compulsory liquidation occurs when the company is unable to pay its debts. Compulsory liquidation can be instigated by one of the creditors acting on behalf of the other creditors. The resultant debt has to be:

- undisputed
- more than the monetary sum of £750.00 and
- the creditor must have informed the debtor of its intention to pursue and collect the debt.

The creditors submit a petition to the court and in the intervening period, as an interim measure, the creditor can apply for a

provisional liquidator. The hearing is then heard in court approximately six weeks after the petition, at which time the court may issue a winding-up order if the petition is upheld.

At this juncture, on the issue of a winding-up order the company ceases to trade and the official receiver acts in its capacity as liquidator to sell off the company assets.

#### *2.2.2.4 Administrative receivership (or receivership)*

Administrative receivership (or receivership) is where a party breaches the terms of its borrowing from a creditor (for example, a bank with a floating charge). The creditor may then appoint an administrative receiver, who must be a licensed insolvency practitioner, to recover the money owed.

In the case of a floating charge, the rights of the creditor are dependent on whether the process it instigated was registered before or after 15 September 2003 (see Part 10 of the *Enterprise Act 2002*).

Before 15 September 2003 the creditor could:

- do nothing and let the insolvency process commence or
- appoint an administrative receiver of their choice or
- appoint an administrator of their choice.

After 15 September 2003 banks' and lenders' rights were slightly reduced, so they are now unable to appoint an administrative receiver, but can still appoint an administrator out of court, i.e. in accordance with the provisions of the *Enterprise Act 2002*.

The procedure before 15 September 2003 meant that the administrative receiver only worked on behalf of the charge holder and not all of the creditors. Also, the administrative receiver did not strive to rescue the insolvent company.

#### *2.2.2.5 Voluntary liquidation*

Voluntary liquidation may be instigated when the company is still solvent. The members

(directors) of the company can cast a vote, usually by passing a resolution, to the effect that the company's liabilities are too great to allow the company to continue in business. This can be due to a debt that cannot be repaid. In this scenario a liquidator is again appointed by resolution and is charged with the realisation and distribution of assets of the company. As a consequence, the company ceases trading.

### 2.2.3 What is the role of the chartered surveyor?

The chartered surveyor can utilise a considerable amount of skills relevant to a construction insolvency situation; these can include measurement, financial costing, procurement/retendering, claims, payments and valuations. The chartered surveyor is therefore well placed to assist an insolvency practitioner at both the pre- and post-insolvency situations.

#### 2.2.3.1 Commercial awareness/practical solutions

Usually the signs are obvious when a company – whether contractor, subcontractor, consultant or client – is in difficulty. However, the chartered surveyor should always be alert to the potential signs which, in respect of a contractor or subcontractor, can be some or all of the following:

- work on site lacks progress or slows without any particular reason
- applications for payment are grossly overvalued or on account payments are requested as well as those catered for in the contract
- unexpected claims for additional payment are made
- materials/plant required for the works are not ordered or delivered to site as expected, or suppliers are frequently changed
- labour resources provided to execute the works are not sufficient for the tasks in hand, or there are frequent changes in the

labour force, suggesting non-payment or delayed payment to operatives

- word of mouth/verbal evidence and
- County Court judgments (CCJs) against the troubled party.

#### 2.2.3.2 Pre-insolvency actions for the chartered surveyor

**(a) Reference to Companies House:** The party experiencing distress can be researched through Companies House ([www.companieshouse.gov.uk](http://www.companieshouse.gov.uk)). The full name of the party involved and/or company number is required, but care must be taken to ensure that the correct company is investigated. This involves a 'Webcheck' against the potentially insolvent party. Credit reference checks using Experian ([www.experian.co.uk](http://www.experian.co.uk)) or other suitable bodies to disclose credit details can be useful, though can lag behind the actual company financial situation. The check may uncover financial difficulties, recent changes in directorship or CCJs against the company. Alternatively, the party being investigated may already have gone into liquidation or administration, and the Webcheck could reveal this.

**(b) Keeping detailed records:** Commence and maintain detailed records of transactions and events. This will ensure that the chartered surveyor is prepared to assist in the process, i.e. has the benefit of accurate and substantial records. Regular meetings with the parties can often assist, the meetings being agreed and minutes taken to form a formal record of the points discussed.

**(c) Investigate verbal evidence:** Word-of-mouth evidence should be followed up with enquiries to express the chartered surveyor's concern and offer assistance/support or expert assistance from others.

**(d) Relaxation of payment terms:** The chartered surveyor may suggest that a client, contractor or subcontractor considers temporarily relaxing the payment conditions

under an agreement, if such action reduces the risk of insolvency. However, the risk has to be within acceptable parameters for the parties involved.

**(e) Reletting work to others:** The chartered surveyor may suggest that a client or contractor considers reletting some of the work to others, subject to the agreement of the parties, if such action reduces the risk of insolvency.

**(f) Direct payment:** The chartered surveyor may suggest that a client or contractor considers direct payments to a (third) party, again with the agreement of all the parties, if such action reduces the risk of insolvency.

**(g) Termination:** If the party is in breach of its contract (covered in subsection 2.1.3) consider terminating the contract.

#### 2.2.3.3 Applications for payment

Contractually, the applications for payment may be on a 28-day basis and this obligation must be maintained. In due course there may be time to suspend the next payment due. However, it is advisable to inform the directors of the company involved of any such actions and again follow the procedure set out in the contract.

#### 2.2.3.4 Claims

Claims can often ensue following insolvency and again it is important to follow the contractual procedure. This will involve the correct dispatch of contractual notices: of paramount importance is the timing and method of delivery of the notice. The contract should specify the terms of the giving of notice and if this is not known then advice should be taken. Claims involving bonds, guarantees and the like are discussed in the RICS guidance note *Construction security and performance documents*. However, it is important that these documents are reviewed at an early stage and the salient points reported to the company directors. This may also involve notifying the surety.

The chartered surveyor should ensure that any set-off, contract charges and/or withheld sums are correctly deducted from the party, in accordance with the terms of the contract and the serving of notices to withhold.

#### 2.2.3.5 Valuations

Valuations for the purpose of interim payments should be fair and reasonable but not overstated. The risk for the employer or contractor is that, if an interim valuation is overvalued and subsequently paid and the party becomes unable to carry on, the overvalued element may be unrecoverable or recovered only after considerable time and expense.

#### 2.2.4 Process and procedures when a party becomes insolvent

When a party is unable to pay its debts when they are due, the party has insufficient cash even if all of its assets combined, if realised, would be sufficient to pay off such debts. Consequently, to avoid subsequent insolvency the party may be placed in administration, as discussed in subsection 2.2. In this case, a loan of some type may be sought to enable the party to remain in operation and perhaps complete its contractual obligations. This may in turn lead to corporate recovery of the business.

However, if a party becomes insolvent, the chartered surveyor should consider the following issues:

- If working with the non-insolvent party, it is vital to take urgent action to ensure that the party's interests are protected, whether it is the employer, funder, contractor, consultant, or subcontractor, etc.
- Determine whether there are any other projects with an unresolved situation between the company and the insolvent party (for example, enquiries, tenders, tender lists, schemes in progress or under defects, and retention monies outstanding).
- The appointment of an individual with knowledge of insolvency issues to act as a coordinator in all of the actions taken and

to be the focal point for consultations with the administrator/receiver/liquidator.

- Is legal advice needed?
- A right of set-off is available under insolvency law (the right to off-set monies). Seek legal advice to investigate the most suitable option(s).
- Upon insolvency of a party, consider a claim on the bond as well as any claims against the insolvent party or consequential claims against third parties.
- A final auditable financial reconciliation statement/valuation 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.
- Preparation of a notional final account.

## 3 Practical application (Level 2 – Doing)

Under Level 2 the chartered surveyor must consider practical applications of the issues and not only be aware, as in the previous section, but also carry out some of the activities for which they are responsible. Therefore, this section concentrates on the anticipated duties required of the chartered surveyor, with the added caveat that some of the elements of work are still required to be executed by others such as insolvency practitioners and/or lawyers.

The areas covered by this guidance note are important in that errors can lead to the employer/contractor being exposed to claims for breach of contract due to poorly executed notices and contract interpretation.

### 3.1 Termination of contract

#### 3.1.1 Contractual rights to terminate

##### 3.1.1.1 Contractual provisions

(a) Termination provisions vary for each type of contract. For example, the provisions in the New Engineering Contract (NEC) suite of contracts differ from those in the Joint Contracts Tribunal (JCT) suite of contracts. This guidance note does not comment on each of the mechanisms within each type of contract, but rather on what the chartered surveyor should do in terms of invoking a party's rights to terminate.

(b) Before considering termination, seek legal advice. Such advice may suggest writing and dispatching letters and/or notices, checking the contract before documents are dispatched to the party in breach and the full engagement of lawyers to manage the process. However, there are cost

consequences of engaging a lawyer, the risk of which should be discussed with the employer.

(c) The majority of modern contracts contain a termination clause that details when and how the termination process should be instigated and conducted. The chartered surveyor should gather the necessary information involved in a particular breach and assemble it into the correct notice.

(d) The process of terminating a contract can be emotive, frustrating and certainly disruptive, so following the correct contractual procedure is vital. For effective termination, whether voluntary or involuntary, the reasons for the termination must be given in the termination notice. If no such notice is required under the contract (which would be unusual), then it is advisable to describe the breach or breaches of contract, giving as much detail as possible.

##### 3.1.1.2 Breach or breaches of specified contractual obligations

(a) Most contracts mention breach of contract. A material breach of contract is an event that allows the party not causing the breach to consider terminating the contract, citing the specified contractual obligations. A non-material breach means that the contract will remain and the issue can be rectified under the terms of the contract. Express provisions within the contract or subcontract will usually allow a party to terminate a contract.

(b) Again, following a breach of contract, the chartered surveyor should strictly follow the procedures expressed in the contract. It is a common procedure in most contracts to write and dispatch a formal notice and, if the

breach is not rectified, the party who issued the notice issues a financial statement detailing the financial situation and (usually) the due sum. At this juncture the other party may contest the notice and statement if it considers the breach to be incorrect.

(c) If the termination of the contract is thought to be in breach (i.e. incorrect termination), the other party may well be within its rights to calculate a claim for loss and/or expense. Again, seek legal advice in such a situation to establish whether in legal terms a breach actually exists.

(d) A material breach, such as non-payment of an interim application, may have been committed by a party, but the contract may not be specific on this point. In this instance the chartered surveyor should seek legal advice. This type of dispute may be heard in court, which will decide on the documentation and evidence gathered whether a material breach has occurred based solely on the evidence presented by the parties. It may be that a material breach has not occurred, in which case the other party may be able to claim damages.

### 3.1.1.3 Termination at will

Termination 'for convenience' or 'at will' may be included in a contract, which may allow a party to terminate the contract without having to prove that some event has occurred or breach has been committed by the other party. The following situations could possibly lead to termination for the sake of convenience:

- a party finds the project will be unprofitable or will carry too much risk, making it unviable
- the project has been delayed due to long-term planning issues and/or is suspended indefinitely for a significant period with no foreseeable prospect of it being recommenced
- alternative land use is considered or
- finance cannot be secured due to a lack of pre-lets.

For contractors and consultants to be given the right to terminate for convenience is rare since it would usually be of great detriment to the project if the employer had to seek others through no fault of its own.

Consequently, it is unusual to include such a clause. If included, the termination for convenience clause is usually for the benefit of employers/developers, where the project is subject to a number of factors, such as pre-letting agreements, securing finance, execution of development agreements and planning.

## 3.1.2 Non-contractual termination

### 3.1.2.1 Repudiation

An act of repudiation occurs when a party commits a breach of contract that is sufficiently serious such that it entitles the receiving party to consider the contract as terminated with immediate effect, and to sue for damages (for loss and/or expense) for breach of contract. Whether this is a material or non-material breach will depend upon the severity and effect of the breach and whether it is a contractual obligation.

A clear repudiation of a contract will occur, for example, with the following:

- abandonment of the site or removal of plant by the contractor
- refusal by the party to carry out work
- employment of other contractors to carry out the same work or
- access denial: failure by an employer to give access to the site.

Certain breaches of contract may not be so defined and are therefore open to interpretation. If one party purports to treat the contract as repudiated because of a breach that is not repudiatory, the consequence is that that party will have committed wrongful termination and will be in breach. In this situation, where there is doubt about whether or not a breach is repudiatory it is worth considering instead

exercising a contractual right to terminate through the contract. This may have a consequential effect on the level of damages, which may well be less than for a repudiatory breach.

### 3.1.2.2 Frustration

Frustration occurs when neither party has defaulted on the original contract but other unforeseen circumstances have intervened to prevent the contract from being performed as originally intended. The result is that further performance of the contract is not possible, is illegal, or is so inherently different from what the parties contemplated when they entered into the contract that it is considered to be void.

If a frustration event occurs, the contract automatically ends and the parties are excused from their future obligations, although any accrued liabilities will remain. For example, such liabilities could be defects for the work already undertaken and the remaining defects period remains in place.

A frustration event must by its nature go straight to the heart of the contract and would proceed entirely beyond what was envisaged by the parties at the formation of the contract. It is very important that a party gives consideration to the veracity of the frustration event that has actually occurred. This is important if the party is going to rely on frustration to justify the cessation of performance of its obligations under the contract to avoid being in breach, i.e. if it is not in fact an act of frustration.

The following are examples that may seem like frustration but in fact are not classed as frustration events.

- If the project is more expensive to carry out than planned. It is unfortunate, but the contract will continue to operate.
- If an unusual planning event (such as planning approval from the local authority is refused) occurs that is provided for in the contract, the consequences of that event

happening will be as set out in the contract, and it will not be a frustration event. This could occur where planning permission is expected, but the eventuality of planning permission not being gained is catered for in the contract.

- Force majeure or any circumstances beyond the reasonable control of a party that impede or prevent the due performance of the contract. In this case, no automatic entitlement is available to the party suffering the force majeure. An example of this could be a civil riot.

## 3.2 Corporate recovery and insolvency

### 3.2.1 Types of appointment

The various categories of insolvency are discussed in subsection 2.2.2; here we give general details of the types of appointment. In terms of corporate recovery and insolvency and the various appointments, these issues have been grouped into the following three subcategories. Not all are applicable to the chartered surveyor, but it is often the case that the chartered surveyor assists in part of the processes, providing information in a supporting role:

- formal insolvencies
- corporate recovery procedures and
- receiverships that are not treated procedurally as insolvencies.

### 3.2.2 Formal insolvencies

#### 3.2.2.1 Administrative receivership

An administrative receiver may be appointed to manage the affairs of a company by a secured creditor who holds a debenture agreement containing floating or fixed and floating charges over the whole, or substantially the whole, of a company's assets.

Upon the appointment of the administrative receiver, the floating charges will crystallise.

The administrative receiver will treat the business assets covered by the charges in such a way as to recover the money due to the secured creditor. If the administrative receiver deems it to be in the best interests of the secured creditor, the business will continue to trade.

### 3.2.2.2 *Bankruptcy*

A bankrupt is an individual against whom the court has made a bankruptcy order. A court can declare a person bankrupt on petition from the individual, from one or more of their creditors, or from the supervisor of an individual voluntary arrangement. The bankruptcy order indicates that the person is unable to pay their debts and, subject to certain exceptions, deprives them of their property, which can then be sold in order to pay their creditors.

### 3.2.2.3 *Sequestration (Scotland)*

This is the bankruptcy process of an individual or partnership (firm) in Scotland. The petition for sequestration can be presented by a creditor or trustee acting under a trust deed.

The court issues a citation, or warrant, to order the debtor to appear before the court within 14 days to state their case as to why sequestration should not be awarded. If the debtor fails to appear, sequestration is awarded.

### 3.2.2.4 *Creditors' voluntary liquidation*

Creditors' voluntary liquidation usually relates to an insolvent company and is commenced by a resolution of the shareholders. Usually an insolvency practitioner is appointed. The appointment can be a shareholders' appointment or, alternatively, an independent insolvency practitioner.

### 3.2.2.5 *Members' voluntary liquidation*

The directors of the company, or the majority of its directors, are responsible for a members' voluntary liquidation and make a

declaration of solvency. In the declaration of solvency, the directors state their opinion that the company will be able to settle its debts in full plus interest within a period not exceeding 12 months of the company being placed into liquidation. In terms of timing, the declaration must be made within the five weeks immediately preceding the date of the passing of the resolution for winding up. Liquidation takes place when the resolution is passed.

### 3.2.2.6 *Compulsory winding up*

The court orders a compulsory winding up as a result of the presentation of a petition by one of the following:

- the company
- its creditors
- its directors
- one or more of its shareholders or
- the Secretary of State.

### 3.2.2.7 *Partnership winding up*

The court orders a compulsory winding up as a result of the presentation of a petition by the members of the partnership or a creditor.

### 3.2.2.8 *Provisional liquidation*

Usually a provisional liquidator is appointed by the court after the presentation of a petition for winding up in order to protect the assets of a company before a winding-up order is made.

Where a provisional liquidator has been appointed, the case is not usually treated as insolvency until a winding-up order is made and a 'permanent' liquidator is appointed.

## 3.2.3 *Corporate recovery procedures*

### 3.2.3.1 *Company administration*

The court may appoint an administrator following an application by the company, the company directors, or one or more of its creditors. Alternatively, an administrator may

be appointed out of court by the company or its directors or a holder of a qualifying floating charge.

The administrator is obliged to perform the following general functions:

- attempt to rescue the company
- if for whatever reason a rescue is not practicable, the administrator is required to achieve a better result for the company's creditors as a whole than would be achieved in a winding-up situation and
- if the second option is not practicable, the administrator is required to produce the best result for the secured and preferential creditors without unnecessarily harming the interests of the creditors as a whole.

**(a) Partnership administration order:** The court appoints an administrator following an application by the members of the partnership or by a creditor, which has the following effects:

- it allows the partnership, or part of it, to survive in a restructured format
- it allows for the approval of a partnership voluntary arrangement and
- it allows a more favourable realisation of the company's assets than would be obtained from winding up the partnership.

**(b) County Court administration order:** The court administers the scheme, which is only available to individuals, and issues an order for regular payments to be made over a period of time in settlement of debts.

**(c) Deceased persons' administration order:** The court issues an order made for the administration of a deceased person's estate. However, this is unlikely to be used in a construction scenario.

**(d) Deed of arrangement:** An individual makes the arrangement, usually with legal advice. This is also a method by which the individual can endeavour to arrange terms of payment with the creditors.

**(e) Scheme of arrangement:** This is generally used to describe a compromise or

arrangement between a company and its creditors or members, or any class of them, which may involve a scheme for the corporate reconstruction (of the company).

**(f) Voluntary arrangement:** This provides an alternative to bankruptcy or liquidation, with fewer restrictions, giving the person appointed to deal with the arrangement more flexibility to manage and/or realise some or all of the company assets. Usually a licensed insolvency practitioner is appointed. Also, a supervisor can be appointed to manage the process in terms of the company, which could be a chartered surveyor with the relevant experience.

### 3.2.3.2 Procedures not treated as insolvencies

**(a) Fixed charge receivership:** A receiver, or receiver and manager, is appointed by a secured creditor who holds a fixed charge over the specific assets of a business. The assets will be used for the benefit of the secured creditor.

**(b) Agricultural charge receivership:** A secured creditor can appoint a receiver under the *Agricultural Credits Act 1928* over the assets of a farm estate. Again, this is unlikely to be used in a construction scenario, unless the development involves change of use of planning and/or the construction of a scheme on agricultural land.

#### **(c) Law of Property Act receivership:**

A lender, such as a bank or building society, can appoint a receiver of a mortgaged property under the *Law of Property Act 1925* to recover money advanced. The receiver will usually also try to arrange for the property to be sold or will be responsible for collecting rents so that the revenue can be maximised. The business may continue to trade independently of the receiver's appointment.

**(d) Court-appointed receivership:** The court appoints a receiver to collect chattels or property. Property is not actually invested in such a receiver, but their appointment acts

as an injunction restraining other parties from realising company assets that the court-appointed receiver has been appointed to receive.

### 3.2.4 Understanding the role of third parties

Third parties are more often than not used as a surety and their role is to basically make good on a claim on the bond in the case of default. This aspect is discussed in detail in the RICS guidance note *Construction security and performance documents*.

#### 3.2.4.1 Step-in rights

A collateral warranty may contain 'step-in rights', which relate to construction and property contracts in that the named beneficiary in the collateral warranty can 'step in' and effectively assume a role. For example, if on a project a developer becomes insolvent and there is the benefit of a collateral warranty, the third party (usually the funder) can step in and assume the role of the developer. In doing so, the third party can honour the payments due to the contractor and consultants and to all intents and purposes take the project to completion. Step-in rights are invoked, for example, when the employer becomes insolvent. It is essential to check that step-in rights are enforceable, and the chartered surveyor should take advice on this issue if not experienced in the matter.

A collateral warranty may have also been required for key subcontractors so, in the same way as above, the beneficiary may be able to exercise their step-in rights if the main contractor becomes insolvent. Similarly, and if the collateral warranty exists, the beneficiary could step in if a construction consultant commits a material breach of their contract or, again, becomes insolvent. In addition, beneficiaries will need to be informed if the employer becomes insolvent.

#### 3.2.4.2 Insolvency and bonds

Most construction contracts have a protection mechanism in the event of

insolvency which manifests itself in the form of a performance bond, guarantee and retention funds. See the RICS guidance note *Construction security and performance documents*.

#### 3.2.4.3 Floating charge/debenture fixed charge

A 'floating charge' is a charge that 'floats' over the whole of the party or company and comes to fruition upon the default or breach. An administrator (administrative receiver if the floating charge was created before 15 September 2003) is appointed by the holder of any debentures of the company secured by the floating charge. Debentures are the most common form of long-term loans that can be taken by a company, and have a lower interest rate than overdrafts, for example. The administrator then has the power to deal with the assets of the company (whether by sale or otherwise) that are covered by the floating charge. The proceeds go to the charge holder to pay some or all of the debt.

#### 3.2.4.4 If the employer becomes insolvent

If the employer becomes insolvent, the contractor must act strictly in accordance with the terms of the contract and terminate the contract, if provisions allow it to do so. It may be that a new contract can be negotiated to complete the works. The contractor must decide whether to secure the site and/or withdraw from the site. However, the site must be made safe and secure until its future is decided.

- The contractor may inform subcontractors to remove their materials assuming they have not been invoiced and paid for by the contractor and in doing so there are no trespass implications.
- The chartered surveyor will be required to issue a valuation statement to the nominated person dealing with the insolvency, consisting of a final account and any claims such as loss and/or

expense. Due care should be exercised to be accurate and to give the current position on any retention, outstanding claims/issues and, if late, any effect of liquidated and ascertained damages.

- This process may indicate a sum due to the contractor or, more unusually, to the employer if, for example, extensive defects have been uncovered.

design or progress. An insolvent party will often fall into one or both of these categories.

#### *3.2.4.5 If the contractor becomes insolvent*

If the contractor is no longer able to continue, the chartered surveyor must issue the requisite notices and closely follow the processes and timelines detailed in the contract and terminate the contract. A breach will inevitably incur if the contract is not followed precisely, which would lead to the contractor potentially receiving a claim from the employer.

- Again, the chartered surveyor should issue a valuation statement with the current position of the works, detailing all risks, liabilities and claims.
- If outstanding works remain, a tender process may be required to complete the project with an alternative contractor. An option would be to novate the services of an alternative contractor.

#### *3.2.4.6 If a subcontractor becomes insolvent*

Usually the contractor or subcontractor will dispatch the necessary notice(s) to the insolvent party. This will assume that steps to prevent insolvency have already been taken as outlined in paragraph 2.2.3.2, such as relaxing the terms of payment, and holding discussions or meetings on or off site with the beleaguered party.

The contractor or subcontractor is usually within their rights to terminate a contract if the party considered as being insolvent fails to perform under the contract, including the supply of design, goods or services, and/or a failure to perform regularly and diligently with

## 4 Practical considerations (Level 3 – Doing/advising)

The final part of this guidance note considers the practical level of doing/advising that a chartered surveyor should take into account when encountering insolvency, termination of contract and corporate recovery. The chartered surveyor may be required to give reasoned advice to their client on how to progress a project following a contractor's or employer's insolvency, or to give advice to a contracted party following insolvency of the other party. If in any doubt, legal advice should be sought, as this area is peppered with risk, especially if the contract is not specific on the issue being considered. This guidance note covers the general construction issues for a project with which the chartered surveyor should be comfortable in advising a client.

### 4.1 Termination of contract

#### 4.1.1 Strict adherence to the contract, formal notices and notice periods

On insolvency, it is likely that a contractor will be unable to progress the works. Consequently, the contractor's obligation to carry out the remaining works is effectively suspended. The chartered surveyor can advise the client concerning the relevant clauses in the contract on termination, although it must be stressed that legal and/or technical assistance should be sought if there is any doubt on the interpretation of the clauses or the chartered surveyor does not have the relevant experience.

Termination of the contract should not be made prior to insolvency as this will no doubt open up the party wishing to terminate to a charge of breach of contract from the receiving party.

It could also be construed as an endeavour to undervalue the company and its assets.

The contract should clearly spell out the parties' termination obligations. Without contract termination provisions, the parties must rely on common law, which permits termination in the event that the other party commits a material breach. A contractor is normally provided with the right to terminate and/or suspend their work only in the event that the employer fails to pay **undisputed** amounts after notice and an opportunity to remedy the situation. However, if the amount is disputed, additional expert advice may be necessary to ensure the position taken is as secure as possible. In some cases the contractor may have the contractual right to suspend their obligations and/or work due to some material breach by the employer. The employer will usually reserve the right to terminate the contract for material breach, insolvency or convenience.

#### 4.1.2 Proper advice and timing

The contract will stipulate what is considered to be a material breach, how and when to dispatch the notice(s), and the period to wait until the (final) notice of termination can be served. This process, procedure and timing can differ for each type of contract. Upon notification of the breach, the receiving party should have time to rectify the issue.

If the issue is not rectified within the prescribed period then the contract can be terminated. Again, it is advisable to consider legal or technical advice on termination.

In an insolvency or termination of contract situation a main contractor/subcontractor should consider doing the following.

- Withhold payments and the release of retention monies in accordance with the *Housing Grants, Construction and Regeneration Act (HGCRA) 1996*, s.110, and all revisions thereto, and the *Local Democracy, Economic Development and Construction Act 2009*.
- Secure the site and make it safe, and secure both contractors' and subcontractors' materials and plant.
- Make use of existing temporary site set up.
- Employ a security firm on a visiting or permanent basis.
- Decide whether to retain scaffolding/ structural issues, as this will probably be owned by a third party.
- Obtain legal advice or advice on termination of the contract.
- Ensure the project has adequate interim insurance and inform the insurer about the situation. Think about fire, theft and deterioration through inadequate weathering. The contractors' insurance obligations may well cease when the contract is terminated.
- Make an inspection of the site and record the progress accurately.
- Make a schedule of the works to complete as at the date of termination.
- Make a schedule of materials on site and inspect materials off site. If they are stored at the insolvent parties' premises and have been paid for by the employer, make an arrangement to move them to alternative secure premises.
- Serve an 'urgent work notice' and/or 'repairs notice' as necessary to further safeguard or secure the site and environment.
- Under the current *Construction (Design and Management) (CDM) Regulations 2007*, the client is required to ensure continuity with both a CDM coordinator and main contractor. Therefore, in an insolvency situation, ensure the employer takes on the responsibilities of the main contractor (and CDM coordinator if the contractor was performing this function) for site safety from termination of the building contract until the appointment of a new main contractor.
- Advise on the options for completion of the project.
- Advise on the options for claims, such as bonds, guarantees, collateral warranties, loss and/or expense, prolongation, disruption, overvaluing of the works, professional indemnity claims for consultants, extensions of time, and liquidated and ascertained damages.
- Obtain and collate design information, specifications and drawings. Obtain any technical advice or reports on installed work and/or contractors' specifications.
- Advise a schedule of defects is made at the date of termination. This may involve some intrusive investigation if it is reasonably anticipated that works were not installed satisfactorily.
- Send enquiries and obtain quotations for the making good of defects on a competitive basis.
- Liaise with the insolvency practitioner.
- Advise as to whether professional indemnity insurance is being maintained or is at risk of lapsing.
- Write and issue a notional final account.
- Write and issue a completion final account.
- Complete general administration of the project, including financial monitoring and retendering.

#### 4.1.3 Suspension of payment

Payments that are due must not be delayed and also must not be unfairly reduced in an attempt to prepare for possible insolvency (i.e. not undervalued). Before insolvency is proven, delaying or reducing payments arbitrarily is unreasonable, is not authorised under the contract and can have a detrimental effect to the party being considered and also to the project as a whole. If the interim payments are undervalued, the contractor is denied their operating capital and may struggle to pay their debts. Conversely, overvaluation may in the case of subsequent insolvency involve the recovery of the overvalued monies which, in

the circumstances, will be difficult to achieve. It may also lead to professional indemnity issues which can be avoided if work is properly and reasonably valued in the first place.

Once insolvency is fact, a 'withholding notice' is not required in accordance with the HGCR 1996 (s. 111(10)) as this still allows the use of 'pay when paid' clauses in an insolvency situation.

## 4.2 Corporate recovery and insolvency

### 4.2.1 Preparation of reports

Various reports will be required in an insolvency situation; these can be prepared by the chartered surveyor and generally consist of the following.

#### 4.2.1.1 Notional final account

This is an account which assesses the party's liability to the insolvent company and shows the implications on the contract. It may be that, as a result of the insolvency, the notional final account will be higher than the anticipated final account before insolvency. This is because the notional final account will recognise the cost incurred by the party at the time of insolvency and will build on that cost to show the cost to complete (had the original contractor completed its works).

The difference between this amount and the original sum as a commitment to complete the works is a debt, the same amount, or a gain. Generally the difference is a debt since appointing a new party to complete the construction project has inherent additional costs.

#### 4.2.1.2 Completion final account

The completion final account is in effect the **contract** final account. Whether or not this is different from the notional final account will depend on the nature of the project and the issues arising, but the final account will include any claims, such as loss and/or

expense, disruption, prolongation, acceleration, etc. and so consequently the timing of the final account is paramount. On many contracts, if the final account is issued after practical completion this sets in motion timing issues as set out in the contract provisions, which can be construed as compliance with the contract. Therefore, it is essential to ensure that the final account is complete and as fully substantiated as possible.

#### *Sample notional final account*

Appendix A is a simple and indicative notional final account based on an in situ concrete subcontractor originally contracted to complete the shell of an office block. The example is a generic construction situation; in reality the detail would be far more significant and wide-reaching. The values and rates are for the purpose of an example, and the notional final account has been simplified.

At the date of insolvency the value of the works is £825,000 for the subcontractor, if they had completed the works and were solvent. By interim monthly payments by the main contractor, Oldco Ltd, to the subcontractor, Smallco Ltd, a net payment to date of £454,000 has been agreed (net of retention).

Works to complete involve further in situ concrete work, some defects and some making good. The total revised cost of the in situ concrete works is therefore £1,013,500.

Subtracting the original value of the works shows a resultant debt of £188,500 (with a retention of £22,700 having already been deducted), which leaves a debt from Smallco Ltd of £188,500. The notional final account should put Oldco Ltd back into the position it was in pre-insolvency, hence it shows the liability for that sum. The chartered surveyor will be able to regularly update the notional final account until the project reaches completion. At completion, a completion final account can be issued.

Since the amount due from Smallco Ltd is large and is not covered by the subcontractor's retention fund, Oldco Ltd can consider a claim through the bond and/or Oldco Ltd could register as a creditor.

#### 4.2.1.3 Progress report

This report should accurately record the progress made against the construction

programme and the following issues should be recognised and expanded upon if there is any likelihood of further risk or concern:

- commencement and completion dates, key milestones, partial handovers and anticipated handover(s)
- procurement, monitoring and subletting of subcontracts for work and the supply of materials
- claims compilation, submission and likely outcome
- extension of time claims/extension of time granted to establish any deficit
- preliminaries, site set up, scaffolding
- health and safety, CDM, identification of any areas that need populating with relevant details to complete records
- progress on design, drawings, specifications and relevant documentation and
- record keeping, i.e. labour, site diaries, plant and materials, material on site and off site.

Also refer to the RICS guidance note *Damages for delay to completion*.

#### 4.2.1.4 Defects report

This type of report will be required if, for example, on the insolvency of a contractor it is discovered by visual or physical (intrusive) checks that the standard of workmanship or materials on the project has failed to meet the specified contract obligations. This could be a major variance to the specification or drawings and could be uncovered.

Unfortunately a symptom of financial problems on a project may be the ‘cutting of a few corners’, so the chartered surveyor should be vigilant in endeavouring to spot any non-compliance. An example could be a more economical external cladding system for a structure that looks adequate aesthetically, but fails to meet the insulation, acoustic or weather resilience criteria. In accordance with the instructions of the employer and/or the insolvency practitioner,

defects reports can be commissioned from independent consultants or experts to investigate non-compliance and offer solutions.

The cost of such reports should be detailed in the final account. It may be that the cost can be subsumed into larger, more substantial claims on the bond that would include reports, defects, procurement, reletting and completion of the project. See the RICS guidance note *Construction security and performance documents*.

#### 4.2.1.5 Report on bonds and collateral warranties

In an insolvency or termination of contract situation it is advisable that a report is written to investigate the type of bond issued by the contractor, the way it operates and the timings and procedures necessary to satisfy the surety. Similarly, with a collateral warranty the report should consider the parties and how the warranty is to operate if there is a breach. Upon termination there is likely to be a claim situation or call on the bond, and the mechanism for such a call will be stipulated in the bond wording. A collateral warranty will give some of the parties recourse should another of the parties be in breach of the obligations. Both issues are described in more detail in the RICS guidance note *Construction security and performance documents*.

#### 4.2.2 Provision of advice to official receiver/insolvency practitioner

The chartered surveyor will have in-depth knowledge of the project and, in an insolvency situation, will probably be best placed to provide information on the position of the project/works in respect of finance, progress and management. The 2011 changes to the HGCRA 1996 in respect of insolvency now allow the notified sum to be withheld in accordance with the Act and/or the scheme. The situations where this can arise are as follows:

- when the insolvency occurs after the expiry of the time required to serve the counter notice and
- when the contract allows the withholding of sums in the case of insolvency, i.e. there are no clauses to the contrary.

A notice of intention to pay less (superseding a withholding notice) can be sent to the receiving party with the relevant information detailing the amount(s) and the ground(s) – insolvency being one – before the payment is due, observing any time obligations in the contract. This notice is required for payments **prior** to insolvency.

Every project is different and uses a variety of design, structures, materials, services and finishes; for this reason the insolvency practitioner for a construction scheme must have a construction-based skill set. The chartered surveyor will be able to supplement this skill set with in-depth practical and technical knowledge as a ‘specialist’ in the project. When giving advice to the insolvency practitioner the following issues should be considered.

- Report on and review the insolvent company’s financial records to verify the overall financial book debt position.
- Liaise with the insolvency practitioner to report and notify the company’s debtors of the trading/financial position.
- Report on potential recovery from debtors and assist with recovery of company records relating to contract debtors and pursuit of debts, if so instructed.
- Advise on bonds and collateral warranties and form a weighted list which presents the best opportunity for financial recovery. Provide information for the surety (legal advice may need to be taken).
- Liaise with the insolvent company’s directors to prepare ‘asset sales pack’ information on current contracts.
- Obtain a letter of permission to carry out work on behalf of the insolvency practitioner/administrator.
- Calculate risk for best and worst ranges of estimated realisation of assets for book debts.

- Assist and negotiate novation agreements for ‘live’ contracts and subcontracts.
- Liaise with the insolvency practitioner to notify the company’s debtors of the trading status and financial position.
- Assist with recovery/collation of company records relating to contract debtors, where instructed.
- Where instructed, assist the insolvency practitioner with the review and settlement of subcontractor and material supplier creditor claims.
- Pursue/recover contract book debts, where instructed by the insolvency practitioner.
- Assist the appointed insolvency practitioner to review any legal action necessary to recover disputed book debts. This may require additional legal and/or technical advice.

#### 4.2.3 Administration of fixed charge receiver appointments

This is a role that can be carried out by a chartered surveyor with the commensurate experience. A fixed charge receiver may be appointed by a lender (possibly a bank or building society) with a mortgage, charge or other security over the property or other specified assets, such as in a development scheme. The appointment of a fixed charge receiver is reasonably rapid and fairly inexpensive. The fixed charge receiver will generally have wide powers to realise assets and, in respect of suitable property, collect rent. Unlike many other insolvency appointments, a fixed charge receiver need not be a licensed insolvency practitioner, and specialist chartered surveyors are commonly appointed. Chartered surveyors will generally be RICS members, but many will be members of the Association of Property and Fixed Charge Receivers (NARA) and comply with NARA’s voluntary code.

NARA has its own code of practice to which all of its members must adhere, in addition to the RICS rules of conduct and regulations.

#### 4.2.4 Reviewing construction/development projects

As part of the chartered surveyor's supporting role to the insolvency practitioner there are several important issues to be considered. These may be instigated by an instruction from the insolvency practitioner and will assist in the maximisation of the value of contracts, subcontracts, claims, land, rents and property sales. The broad range of issues is as follows.

- **Valuations.** In terms of property, insolvency practitioners and the lender will require information on the value of a property. This will require in-depth knowledge of local residential, commercial or other markets. It may be prudent, therefore, to seek assistance from chartered surveyors with expertise in the commercial property, residential survey or valuation, or valuation of businesses or intangible assets pathway.
- **Building, project management and construction consultancy appointments.** These may involve structural surveys, remedial surveys, planning issues, boundary/right of light issues, procurement, tendering, life cycle costing, building information modelling, project monitoring and document control. The chartered surveyor may be tasked with assisting the insolvency practitioner with one or several of these services to help with completion of a part-built development and completing the resultant scheme on budget and on time.
- **Planning issues.** The planning process can take time to implement through the planning system. Therefore, it can be prudent to progress existing planning applications and/or new applications submitted to enhance the value of the project. It may be that existing planning permission can be improved upon and renegotiated, taking into account new planning law or new revisions to the relevant development plan/framework.
- **Material plant and machinery,** such as fixed assets, are tangible assets with a financial value. It may be the case that the scaffolding is owned by the scaffolding subcontractor but other items such as site

set up, tools, plant and material on and off site may be owned by the insolvent party and can be assessed for value. These assets could be built up into a concern to be sold off as a whole, or may be sold individually, dependent on the best value to be achieved.

- **Asset/property management, lettings and sales.** Asset value can be enhanced by managing the daily processes for the properties with the view to maximisation of property liquidity prior to the property being realised.
- **Environmental risk.** Environmental due diligence will most probably be required to set out the liability for potential and known hazardous and non-hazardous contamination associated with the project. It may be the case that there is a more effective method for treating contamination issues that can benefit the scheme and value recovery.
- **Securing the project.** It is important to do this as soon as it is known that a contractor has become insolvent. Swift, decisive action in erecting appropriate fences/barriers, appointing a security firm and locking away valuable materials may prevent losses that would otherwise materialise over time. The insolvency practitioner will need to be briefed on which items of plant and materials have been paid for and therefore rightful ownership decided upon.
- **Claims: liquidated and ascertained damages.** Most forms of building contract include a clause entitling the employer to a specified level of damages, known as 'liquidated and ascertained damages' (LADs), if the contractor is late in handing over the building. LADs are essentially a contractual right to a pre-determined sum for the period of delay.

Most construction contracts contain relevant clauses entitling the contractor to an extension of time (EOT) of the contract period as a result of events (relevant events) for which the employer is responsible. In such cases, where the EOT is granted, the date for practical completion is moved back by the agreed EOT

period. Where, for whatever reason, the works were not completed by the revised date for practical completion and there is no EOT in place, the contractor is exposed to LADs.

In an insolvency situation, the chartered surveyor should be aware that the following no longer apply.

- As long as the insolvent party is under the obligation that gives rise to the payment liability before it goes into administration, the fact that the payment liability itself does not fall due until after the administration (and that the amount of the liability is not quantified until after the administration) does not stop the payment liability being set off.
- Insolvency set-off for a party in administration does not operate unless and until the administrator gives notice of their intention to distribute assets to unsecured creditors.

With regard to claims, when a party becomes insolvent, although each contract and situation is different, there are a number of issues that can be addressed with the careful compilation of a fully substantiated claim that is compliant with the contract. Some examples to consider are:

- performance bonds, on demand or default
- parent company guarantees
- professional indemnity claims for consultants
- delay claims: loss and/or expense, prolongation, disruption
- collateral warranty claims, step-in rights (the lender) and
- subject to timing and permission from the court, adjudication, arbitration or mediation.

#### 4.2.5 Risk evaluation

To mitigate risk, chartered surveyors can act early to assess the options, take legal/technical advice and ultimately influence the transition. Check and act on the following.

- Ensure that, before parties are engaged in the tendering process, their track record, both financially and on site, is fully investigated: look at Companies House

documents, obtain references and request parent company guarantees.

- Ensure the client is protected contractually with relevant protection clauses – bonds, retention, collateral warranties, professional indemnity and LADs.
- Look for early signs of insolvency: late payments, lack of labour, legal actions, CCJs and repossession of plant and materials.
- Collate documentation for claims, design, drawings and payments.
- Check site security, permission from the employer, and hence enforceability. Be cognisant that a supplier is unable to access land and property owned by the employer or a third party.
- Check information: permission, copyrights, collection, storage and monitoring.

A generic example of a construction risk assessment matrix is shown in Appendix B. Every project will have different factors affecting it, and therefore the matrix can be tailored to suit the particular set of criteria required.

#### 4.2.6 Cash flow projections

These can assist the funder and the insolvency practitioner in the assessment of financial dealings with an insolvent funder or contractor. Cash flow projections also provide a good indicator to predict insolvency. There are many factors to consider for a construction cash flow prediction, such as:

- client/contractor changes to initial design, inclement weather, variation to works, labour shortage and production targets
- slippage, delay in agreeing variation/day works and client delay in settling claims
- abnormal costs/technical detailing; for example, contamination, foundations, archaeological issues, underestimating project complexity, estimating error and undervaluation
- time period to appoint a new funder/contractor/subcontractor/supplier and
- labour strikes/shortages.

Further information on cash flow forecasting can be found in the RICS guidance note *Cash flow forecasting*.

#### 4.2.7 Asset disposal

When a party (as opposed to an individual or a partnership) becomes insolvent, the law provides two types of outcome. One is that the company enters into a corporate recovery type of proceeding, usually with the objective of enabling all or part of the company's business to continue. The other is liquidation, whereby the company ceases to trade and is wound up.

In some cases an insolvent company will go through both of the above procedures to some degree. For example, an administrator is appointed and sells the party's primary business as a going construction business. Following the sale, the administration ends and the company goes into liquidation, with the liquidator distributing the sale proceeds and any other assets of the company to the party's creditors.

The chartered surveyor may be able to assist in the administration process in recording, scheduling and valuing individual assets. The benefit of such an asset sale is that the liabilities associated with the business are left with the insolvent company on the whole, and the purchaser of the assets can utilise any remaining goodwill from the business.

## Appendix A: Simple notional final account example

Typical notional final account summary		(£)	Cost (£)
Project	In situ concrete office block		
Main contractor	Oldco Ltd		
Subcontractor	Smallco Ltd		
Value of contract works			750,000
Value of additional works (variations etc.)			75,000
Total value of works			825,000
Liability for Oldco Ltd to carry out construction works:			
Payments to Smallco Ltd (net) to date		454,000	
Add	Cost of works to completion by others		
a	Reinforced concrete to slabs, beams, downstands and the like, including formwork, rebar falsework and finishes 450m <sup>3</sup> × £1,200/m <sup>3</sup>	540,000	
b	Defects: gun out and replace 6 No. reinforced columns 6 No. × £1,500/No.	9,000	
c	Making good to works including risk for the defects period of 12 months 1 No. × £10,500	10,500	
Total revised cost of the project works			1,013,500
Less Smallco Ltd total value of the works			-825,000
Total			188,500
Resultant monies due from Smallco Ltd			188,500

## Appendix B: Construction project risk assessment matrix

Project title: Project ref:	Potential risk factors	Author(s):		Risk indicators	Date:	Named risk person
		Impact (H/M/L)	Probability of risk arising (H/M/L)			
<b>Financial</b>	<p>Employer/funder problems:                      Funders' insolvency                      Failure to deliver promised funds?                      Last minute budget changes – underfunding?                      Matched funding not available?                      No infrastructural support?                      Funding delays in monies being delivered?                      Funders' linking funding to deliverables</p> <p>Contractor: project budget overspend</p> <p>Any subcontractor/supplier organisations or individuals unable to meet deliverables due to financial difficulties</p>	<p>Estimate:                      High                      Medium                      Low</p>	<p>Information from any source accounting for risk</p>	<p>Control mechanisms</p> <p>Outline proposal already submitted and approved                      Are notes minuted and recorded. Any problems?                      Regular meetings with funders/employer/advisers                      Regular progress meetings with construction project team</p>	<p>Named person with responsibility</p>	
			<p>Regular (monthly) finance reports                      Regular reporting mechanisms to funder and institutional finance                      Project management systems to control project stages</p>	<p>Designated budget holders (for all partner organisations)                      Monthly finance reports                      Sanctions for overspends                      Expenditure monitoring                      Finance procedures for each partner organisation followed                      Clear contingencies allowances indicated in budget</p>	<p>Named person(s) with responsibility</p>	
			<p>Annual finance audits                      Yearly business plans                      Formal reporting mechanisms</p>	<p>Check subcontractor/supplier organisations' individual finance procedures                      Monitor subcontractors/supplier management meetings</p>	<p>Named person(s) with responsibility</p>	

	Potential risk factors	Probability of risk arising (H/M/L)	Impact (H/M/L)	Risk indicators	Control mechanisms	Named risk person
<b>Legal/ contractual</b>	Lack of appropriate working space for construction project staff Lack of resource on site			Formal health and safety risk assessment undertaken CDM Task taking longer	Health and safety risk assessment action plan Office space commissioned Check against construction control programme, minuted meetings to discuss	Named person(s) with responsibility
	Poor communication between employer and contractor and/or third party organisations County Court judgments filed against the contractor or the subcontractor			Accurate project meeting minutes – circulated and reviewed Independent consultants/advisers on project board Stage reviews and authorisation to continue	Non-disclosure agreement signed by partner organisations Project management system followed to check off project deliverables and ensure each stage signed off by key partners/stakeholders Standard reporting mechanisms in place ensuring external review of project processes Regular internal project team meetings Written agreement between third-party organisations setting out terms and conditions for joint working accountabilities	Named person(s) with responsibility

	Potential risk factors	Probability of risk arising (H/M/L)	Impact (H/M/L)	Risk indicators	Control mechanisms	Named risk person
<b>Resource</b>	Changes in key construction project staff Non-adequate resource			Human resource (HR) processes Appraisal process Adequate staffing Adequate materials/ plant	Develop succession plan Ensure handover mechanism in place Involve other key members in partner organisations in project processes Ensure 'cover' arrangements for illness, etc.	Named person(s) with responsibility
	Appropriately qualified construction staff recruited to undertake project			Recruitment process Appraisal process Liaison meetings with any partners sharing recruitment	Clear and appropriate training plan for researchers developed and implemented All human resources processes in place to manage the recruitment process Weekly supervision undertaken, and as required, from project sponsor	Named person(s) with responsibility
	Project overruns/EOT/potential for LADs			Project board meetings Feedback from professional indemnity (PI) at key project stages Lack of EOT applications	Construction programming. Project systems used to manage project time frames Gantt chart developed and updated regularly to monitor time frames involved for each task Project supervision undertaken by project board	Named person(s) with responsibility