

## HOW TO COPE WITH CONTRACTOR INSOLVENCY

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With UK construction firms going bust at the fastest rate in more than a decade, surveyors should look out for particular signals of insolvency – and know what practical responses they can take.

This article written by BG Partner Stuart Wigley was published by RICS as part of the Built Environment Journal Series. You can find the original [here](#).

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**Headlines on the ill health of the UK construction sector have been appearing regularly this year, with The Guardian in August citing [particularly worrying figures](#) from the UK government's Insolvency Service and the acute impact on the housing sector.**

### ECONOMIC CONDITIONS CAUSING BUSINESS FAILURES

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Increasing material costs, inflation, the rising cost of borrowing, shortages of skilled labour and fixed-price building contracts agreed under different economic conditions have all placed financial pressure on the sector.

The impacts are felt not only by large, high-profile organisations, but also an increasing number of the UK's 342,000 small and medium-sized construction firms that form the foundation of the industry.

When these smaller organisations go insolvent, they affect the supply chain of larger ones. It has been [reported](#) that it is the smaller, specialised subcontractors that are suffering the most, accounting for around 60% of the total insolvencies.

Rebecca Larkin, the head of construction research at the Construction Products Association, has [noted](#) that in recent months, the 'increase in insolvencies has been strongest among larger firms', which,

she said, reflected 'the inevitable knock-on effects of firms going bust further down the supply chain'.

The Insolvency Service [reports](#) that construction has seen more companies collapse than any other sector in the past year, representing 18% of all insolvency cases in the 12 months up to the third quarter of 2023 or 4,272 construction firms.

As a consequence, surveyors working in this challenging and changing environment should be keeping an eye out for particular indicators of insolvency.

### INSOLVENCY PROCEDURES WILL AFFECT RESPONSES

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There are significant differences in the way the financial status of organisations is dealt with under different forms of contract, so it is worth briefly reflecting on insolvency terminology and procedure in the UK.

Most forms of contract will define the actions that can be taken if the financial standing of a company deteriorates. Therefore, if the status of a company changes as a result of financial stress, contract provisions relating to insolvency may enable termination of the contractor's employment.

Under the [2016 JCT contracts](#), when the corporate contractor becomes insolvent, both parties have a right to terminate the contract.

Under clause 91.1 of the [NEC4 contracts](#), reasons R1 to R10 set out the types of insolvency procedures which, should they occur, entitle the other party to terminate the contract. An appreciation of the terminology describing the status of financially

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stressed organisations is critical in applying contract terms and provisions.

For example, the process by which a company's affairs are wound up, eventually resulting in its dissolution, is known as liquidation. A firm cannot trade while it is in liquidation.

In contrast, administration and company voluntary arrangements focus on rescuing the business. Therefore, it is possible for such a business to continue to trade, which is a significant difference from one that is in liquidation.

These two examples highlight the importance in distinguishing correctly the different terms used, and the implications in terms of the actions available under the different types of contract.

Consideration will be needed as to whether it is in the best interests of the employer, and the project, to terminate the contractor's employment.

### **RANGE OF INDICATORS SUGGEST FINANCIAL STRESS**

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For those who manage and work on projects on behalf of clients, key indicators of potential financial stress include the following.

- Slower progress on site will mean expenditure is unlikely to be as forecast, perhaps because the contractor is unable to place orders with subcontractors and material suppliers, or because lack of payment to the supply chain has an impact on its performance.
- Changes in personnel can include higher turnover of staff, who may leave without much notice or planning, disrupting continuity and running the

risk of project knowledge being lost. Staff may also be absent when they would normally be expected to be on site or in the office, or acting out of character because of the increased pressure they are under.

- Material deliveries could arrive late or not as planned, potentially reflecting non-payment of invoices or lack of payment to secure production slots.
- Subcontractors and materials may be withdrawn from a site, with a lack of response from the rest of the supply chain about this.
- Disruption to the normal flow of project information could include subcontractors failing to issue regular progress reports or asking for progress meetings to be rearranged, or project team members and employers being locked out of information-sharing portals.
- Applications for interim payment may be inflated or incorrect.
- Payments may be constantly chased before they are due.
- If attitudes and approaches become increasingly contractual there may already be disputes, delays or issues on a project. The organisation in financial stress may aim to draw attention away from day-to-day issues associated with lack of progress and emphasise disputes with the client team instead.

It is unlikely that all of the above will suddenly occur simultaneously. However, a combination of issues over time, along with discussions on site and project relationships, may lead to concern.

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Those managing projects should then interrogate in greater detail the integrity of the information being provided.

### SEEK FURTHER INFORMATION IF CONCERNED

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If these indicators occur, it is first of all best to get a clearer picture of the situation.

- Dig deeper into the reasons why planned events, progress or payments by contractors and subcontractors have not taken place.
- Request contemporaneous correspondence from the supply chain to validate the facts, and get feedback on actions, progress and the programme.
- Review any notes, meeting minutes and action logs to identify what the agreed deadlines were. Compare them with the current timescales and highlight any areas where dates have been missed.
- Log on to sharing portals regularly to see whether access is prevented, records are not being updated or information is being withdrawn. These may mean that decisions or changes cannot be agreed, or information for regulatory approval or sign-off is not being provided on time or consistent with timescales in the building contract. To deal with this, identify and circulate the specific details, highlighting the potential consequences.
- If the building contract details the procedure for notifying the employer of changes to key personnel or persons in charge but this information is not being supplied, contact the

contractor or subcontractor to request this. Do the new staff or supply chain partners have and exhibit the skills, knowledge, competency and behaviours that the contract requires?

### REMAIN PROFESSIONAL ON PROJECT PROGRESS

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The most effective means of managing any difficulties is undoubtedly to continue to work professionally and punctually, recording progress accurately.

This means, for instance, you should ensure that all responses to correspondence are sent or notifications issued in a timely fashion within the contractual periods.

When work is not progressing on site, continue to visit and record status, taking date-stamped photographs.

If lack of activity results in works being exposed to adverse weather for longer than anticipated, or materials are poorly stored and their integrity is compromised, collate records from inspection software to pinpoint issues precisely on working drawings, accompanied by photographs, and raise these concerns with the contractor or subcontractor.

This evidence will allow you to flag up issues that require remedial action and response. It also means that when interim payment applications are made you can ascertain whether the work in progress accords with contractual provisions and materials have been properly incorporated into construction.

You should ensure, too, that payment applications are accurate and accord with the building contract provisions to avoid potential [smash-and-grab adjudications](#) or overpayments, and regularly review the information held about materials off site.

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### KEEP ON TOP OF CHANGES AND CHECKS

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Monitoring the contract and work on site remains critical. Review the project's building contract amendments if there are any. The clauses relating to insolvency may have been revised, so remaining familiar with these amendments is essential.

You should also ensure you have an executed copy of the building contract, together with an original copy of other completed documents such as performance bonds, collateral warranties and the latest insurances.

Alongside this, monitor the management of the works and set-up on site. This will allow you to raise any concerns about the way materials are stored and whether they continue to be protected, while ensuring the health, safety and welfare of those on site and preventing any unauthorised access.

As part of this approach, ensure that records continue to be provided about those attending site whose function is to review quality, sign off key stages, authorise or inspect, such as building control surveyors, building warranty inspectors or clerks of works.

This will be of particular importance regarding the continuity of as-built information, evidencing compliance with required standards and the collation of details forming the [golden thread of safety information](#).

You should also check that the required certificates and notices continue to be issued and served effectively in accordance with the building contract provisions.

Finally, undertake an updated financial check on the organisation whose status is being queried.

From my own experience, this is rarely conclusive or the sole source of information determining your course of action, because it will frequently involve historic and outdated records; however, it still helps give a fuller picture about an organisation.

### MOVING BEYOND THE ORIGINAL CONTRACTOR

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Any of these events may play out over a period of time.

Your potential response will be project-specific, and help inform a risk strategy. While the detailed plans, legal safeguards and financial arrangements of any response are beyond the scope of this article.

If the original contractor is no longer employed to complete the works, there are a number of ways to proceed.

- Inspect the site and ensure it is secure, protecting it from any unauthorised access and arranging security if necessary. Keep all records of expenditure incurred as a consequence of this.
- Undertake an inventory of the site, recording materials and stage of construction and supplementing this with a photographic record.
- Review the stage of construction and work in progress. Ascertain whether there are any unsafe structures and identify work that must be undertaken immediately to protect what has been completed, and the health, safety and welfare of those in or around the works.

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- Issue all the notices and certificates required under the building contract and review any specific contract amendments.
- Review insurances, bonds and warranties and confirm that the site is insured, issuing the notifications required by those acting as surety.
- Review with legal advisers the appropriateness and implications of any [step-in rights](#) – which enable another party to replace an insolvent party to complete a project – and their impact on current orders.
- Review the project records to ensure the latest information is available. Download information from the project portal in case access is prevented or not possible at a later stage.
- Ascertain the value of the works at the date the contractor was no longer employed.
- Contact those acting on behalf of the contractor to establish a link and maintain dialogue on progress.
- Start to formulate and develop a procurement strategy to complete the remaining works.

Levels of insolvency in the industry are likely to increase over the coming months, with corresponding disruption and impact on the professional and personal lives of many. Being well prepared will lead to better outcomes.



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