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Adam Hiscox on Insolvency in Construction Contracts



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Construction, the not so happy years...

“Nine construction firms going bust every day”

28 April 2009 | By Sophie Griffiths (**Building on line**)

“Another 700 construction companies went out of business during the last three months. This excludes compulsory liquidations, the figures for which are not yet available, meaning the overall figure is likely to be around 1,000 companies in insolvency”.

The Construction Index May 10th 2010



Contract Provisions

Check the termination provisions of the Contract / Sub-Contract

Watch out for the procedures



Performance Security

Performance Bonds

Types of Bond:-

‘On Demand’ – Contract of Indemnity

‘Conditional’ – Contract of Guarantee

Which is which will depend on the drafting

Parent Company Guarantees
Directors’ Personal Guarantees
Advance Payment Bonds



Performance Security

Performance Bonds

However;

Performance bonds are recoverable for a default (breach) by the principal;

No Breach, No recovery under the Bond

Perar v General Surety and Guarantee Company (1994) 66 BLR 72 CA

- Contractor insolvent triggering automatic termination of employment
- Held - no 'breach' for failing to get on with the works as employment had already been terminated
- Therefore the strict terms of the bond were not enforceable
- Many bonds specifically include terms to cover insolvency



Advice on bonds/security...

- Include insolvency situations in your bond and draft as widely as possible [employer]
- Watch the terms of the bond and comply to the letter [employer]
- Consider whether resisting the bond is worthwhile given that some errors by the beneficiary can be easily rectified [bondsman/ contractor]
- Resist entering into high value “on demand” bonds if at all possible [contractor]
- Negotiate other ways to satisfy the employer [contractor]



Retention of Title

General Rule:-

Title will pass when the parties intend it to pass, usually on delivery.

Section 19(1) of the Sale of Goods Act 1979 provides:-

“the seller may, by the terms of the contract or appropriation, reserve the right of disposal of the goods until certain conditions are fulfilled; and in such a case, notwithstanding delivery of the goods to the buyer... the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled”



The “Romalpa Clause”

This is often referred to as a ‘ROT’ Clause or Retention of Title Clause.

Aluminium Industrie Vaasen BV v Romalpa Aluminium Ltd [1976] 1 WLR 676

“the ownership of the material to be delivered ... will only be transferred to the purchaser when he has met all that is owing to [the plaintiffs]”

If effective the amount due to the creditors of an insolvent contractor is decreased but the amount due to the supplier creditor of the insolvent contractor is increased.



Romalpa Clauses

TWO MOST COMMON FORMS:-

Simple ROT Clause

- reserves the supplier's title to goods until paid for

“All Monies” Clause

- reserves the supplier's title until ALL monies due under every contract between the parties has been paid



Has title passed by virtue of the law of property?

Even an effective Romalpa Clause can be defeated by:-

- New product being created – title then vests in the maker
- The goods being a fixture – becoming the property of the landowner

If mixed, an interest in them may remain provided they can be separated:-

- Mixing by agreement – each has an interest in proportion to their respective shares
- Unlawful mixing – parties hold the goods as ‘tenants in common’



What is a fixture?

“It is very difficult, if not impossible, to say with precision what constitutes an annexation sufficient for this purpose” - Holland v Hodgson (1872) LR 7 CP 328

Courts take into account:-

- *How* the article is attached to the land
- The *difficulty of removing* the article from the land and whether any damage is caused to the land
- The *purpose* of the article being placed on the land



Examples...

Bricks and mortar

When used in construction, they are affixed

Heating or ventilation plant

if intended to be permanently in place, they are affixed

Curtains and blinds

are chattels

Kitchen units and sinks

after installation, they are fixtures

Carpets

are chattels





Romalpa clauses can also be defeated by Administration

- Even if title has not been lost in the manner touched upon above, it is still not always possible to walk on site and recover goods.
- In the case of Administration, IA 1986 Schedule B1 paragraph 43(3), Schedule B1 creates a statutory moratorium:-

“No step may be taken to repossess goods in the company’s possession under a hire-purchase agreement except –

(a) with the consent of the administrator; or

(b) with the permission of the court.”

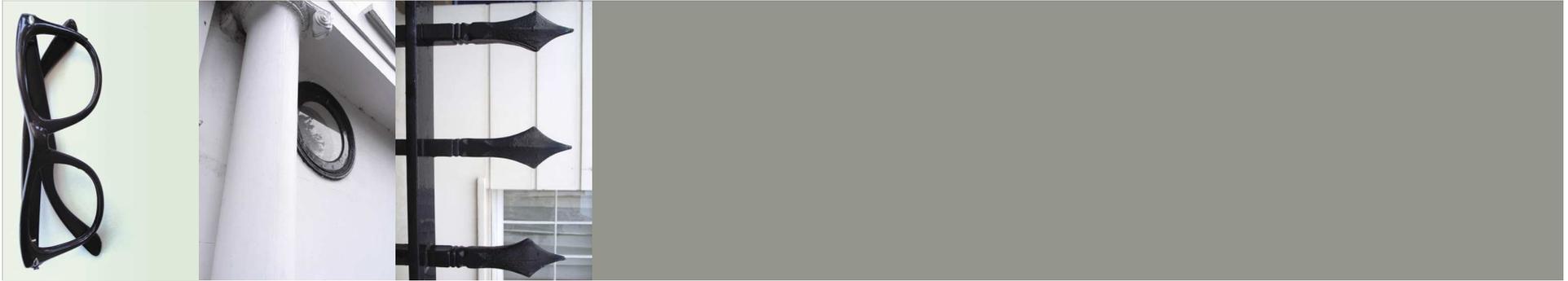
‘Hire-purchase agreement’ is defined as to include a ‘retention of title agreement’



So beware...

- If goods are removed and damage occurs then the persons damaging the property may face criminal charges – Criminal Damage Act 1971 not to mention Burglary under the Theft Act 1968

If the ROT clause has any chance of being defeated then care must be taken.



Practical advice regarding title and insolvency

If you are the employer:-

- make valuations and certificates as detailed as possible
- alternatively, amend the building contract so that the main contractor cannot apply for payment for any unfixed materials on site, and can only apply for work carried out
- if possible, approve the form of contracts entered into down the chain, and try and avoid retention of title clauses being included
- consider taking out a performance bond to cover losses that will arise out of the insolvency of the main contractor
- if faced with an insolvency situation, increase security on site to protect against unlawful removal of goods

If you are the sub-contractor/supplier:-

- notify all parties up the contractual chain from the outset that you have a ROT clause in your agreement
- notify the same parties again as soon as payment becomes overdue
- utilise project bank accounts to facilitate payment direct to the sub-contractors and suppliers
- do not rely solely on retention of title clauses and exercise robust credit control procedures
- take advice on the merits of a retention of title claim as soon as possible



Third Parties (Rights against insurers) Act 2010

- ❖ In force possibly April 2011
- ❖ Replaces the 1930 Act
- ❖ PI Insurance Claims
- ❖ Litigation against Insurer
- ❖ Significant improvement on the 1930 Act:-
 - no need to take the costly step of restoring a defunct company to the register before proceedings can be commenced
 - information can be obtained from not only the insurer but other relevant third parties, for example, brokers or former employees as to the insured's insurance position.
 - insurer can set off any money owed by the insured under the policy, for example the premium, from any amount due to the third party
 - the Act applies to insurance for voluntarily incurred liabilities such as legal costs
 - Not retrospective