

# LEGAL SAFEGUARDS AGAINST CONTRACTOR INSOLVENCY

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## How a developer can reduce the risk in the event of a contractor becoming insolvent

- ▶ How can a developer protect himself against contractor insolvency?
- ▶ Think third party security.
- ▶ Think payment arrangements.

### What's it about?

Despite the economic uplift in the construction sector, financial instability and insolvency remain a threat. However, with some forethought in the project planning stages, a developer can put certain safeguards in place.

### What protections are available?

- ▶ **Parent Company Guarantees:** A PCG usually underwrites the contractor's liability for the full limitation period under the building contract (normally 12 years).
- ▶ **Performance bonds:** A bank or insurer agrees to pay on demand, up to an agreed figure (generally 10% of the contract sum). There are two types: unconditional, or contingent on an underlying liability of the contractor. General purpose bonds usually last until completion or the end of the defects period, while special purpose bonds, eg in lieu of retention or to secure advance payments, last as long as required.
- ▶ **Project bank accounts:** These are opened jointly by the employer and contractor; payments in and out are governed by the contract or a side-agreement. The trustee status of the account protects the cash flow attributable to sub-contractors, should the main contractor fail, making it less costly and easier for the project to be remobilised. Pioneered in the public sector, they are now used more widely.
- ▶ **Direct payment agreements:** These authorise the developer to pay sub-contractors/suppliers directly, bypassing the contractor, such payments being deductible from valuations under the main contract.
- ▶ **Inherent defects insurance:** This is a well-established and affordable product providing single premium no-fault cover against latent defects for 10 years or more after completion, subject to the project passing technical audit. Such cover has ancillary advantages, as well providing a large measure of protection from insolvency, post completion.

### What now?

Owing to the complex nature of insolvency law and the law of guarantees, the technical requirements of these types of protection are particularly demanding, but they can provide valuable financial underpinning in an uncertain commercial world.

The team at Addleshaw Goddard LLP will be happy to discuss the options with you. Please contact Luke Baines or Hayley Cochrane.

## Who to contact

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