INSOLVENCY

When a business has insufficient cash to pay its current debts then it is insolvent. This may be a short-term problem that its suppliers and customers remain unaware of. However, in order to protect your own business, it is important to be alert to all the possible warning signs of impending insolvencies and to take whatever action you can to protect yourself.

Experian offer ECA members, at a discounted cost, a credit rating report. This will help identify, those customers most at risk. It is possible to mitigate some of the risks and costs associated with customer or supplier insolvency; by gathering customer and market research, vetting enquiry documents, employing your commercial acumen and careful management of your own resources.

Overview

The full effects of the current recession are becoming evident, with a number of businesses struggling to stay afloat. The ‘credit crunch’ has left the banks nursing their own balance sheets; as a consequence, funds to bolster under capitalised businesses are hard to come-by. Insolvencies will ensue. Considering the following issues will help members in these difficult times.

1. Market Research

- What is the financial position of both your customer and the overall project employer?
- Who is actually funding the project: government, banks, self-financed, grants etc?
- Is it a speculative build or is the project employer also the end-user?
- Are financial accounts available? Be concerned if they are late in publishing them.
- How viable, in your opinion, is the project? Is it a good risk? Will it fill a gap in the market place?
- Keep abreast of ‘local’ news. Try to understand what are influencing events in the area.

2. Customers

- The first line of defence is, have a robust credit control system.
- Try to have your terms and conditions written into any contract.
- Ask their director to confirm that he believes his company is in a financial position to fulfil its payment obligations.
- Listen to your customer. How do they see the marketplace?
- Where appropriate, ask for either a bank reference or a Parent Company Guarantee.

3. Tendering, Pricing & Quotations

- Does the client appreciate all that is involved in delivering a successful project?
- Is there sufficient time for everyone to price the work and the risk?
- Are project risks identified and placed with the party best able to manage them?
- Is the size of job appropriate to the ‘named’ contractors and suppliers? Will they cope?
- Consider using the ECA Tender and Pre-Contract Check List.
- When asked for either a Parent Company Guarantee or Performance Bond, are there any terms that by their excessive nature may indicate the customer’s own lack of financial stability?

4. Suppliers and Subcontractors

- Vet any 'named' contractor or supplier. Ask for trade or bank references, if these prove unacceptable, you can ask that an alternative company is chosen.
- Check the retention of title position, in regard to the supplier's conditions and your customer's order.
- Vehicle operators and delivery personnel can provide a valuable source of information – delegate, to one person, the responsibility for gathering this information.
- Be wary of any sudden change in the management of your account. Unexpected claims for payment should be investigated and used as an opportunity to negotiate.
- Ensure that any retention fund or performance bond adequately protects you against their insolvency.
- Pay-when-paid, in the event of customer insolvency, is permitted but the contract must say so. The clause must be clear and precise as to which form of insolvency triggers both termination of contract and the withholding procedures.
- Gauge whether the prices you receive are economically viable. Pricing your contract too low leaves you liable to complete the works, at a much higher cost, in the event of their insolvency.

5. Pre-Contract

- Sizeable contractors will be capable of producing a company cash flow forecast. You may be asked for yours and you should ask key sub-subcontractors for theirs.
- Contractors must be 'diligent' in their clearance of defects. They owe their subcontractors a duty of care to complete them in a reasonable timeframe. Upon receipt of a contract that includes a pay-when-paid provision ask that a clause be added that acknowledges the duty of care responsibility.
- Warranties may contain provisions entitling the customer's client to assume their payment responsibilities. Negotiate the warranty terms to reduce the delay before the 'step-in' occurs.
- Check the contract to see if the retention can be placed into a trust fund. This protects against customer insolvency.

6. As Works Proceed

- The free guide: 'Down To Earth' available from the CC&L section of the website, lists in Paper 16, the signs of impending insolvency. Convert to a memo and distribute to your staff.
- Effective Credit Collections, or similar companies, can be instructed to chase bad debts.
- If payment stops (take advice), then issue a notice suspending work and consider making a statutory demand and winding up petition.

7. The Act of Insolvency

- Advise the liquidator of any retention of title claim and establish the total amount of the outstanding debt.
- Tell the liquidator if you suspect the company has been trading while knowingly insolvent or if you had previously been given assurances that you would be paid.
- Pre-pack insolvency can provide creditors with a greater chance of compensation.

FURTHER INFORMATION

Contact: ECA Commercial Contracts & Legal Dept Tel: 020 7313 4818 or visit the website www.eca.co.uk