

The safety net: how to save a project from a falling contractor

Managing and mitigating contractor insolvency risks is essential in a challenging economic environment

According to MBIE, in its 2023 report on industry trends, construction insolvencies comprised 23.5% of all insolvencies. Construction is clearly a risky business.

Insolvency of a contractor poses perils to a project: the project will be delayed, someone else has to finish the job (usually at a higher cost and under strained conditions), unpaid subcontractors may become uncooperative, and materials that have been paid for are at risk of disappearing. There are several ways to manage and mitigate such risks from the project outset.

Due diligence during tender assessment

The failures of Mainzeal and Orange-H Group show that even big brands are not immune. When assessing tenders, consider asking for financial information as part of the process and look for early warning signs such as inability to procure a bond or high staff turnover.

Monitoring during the project

Late payments to subcontractors can be an early indicator of financial distress. As part of the payment claim and payment schedule process, consider seeking confirmation from the contractor that all undisputed amounts payable to subcontractors have been paid.

Retentions

Withholding part of the price until the end of the project is common practice in New Zealand (albeit subject to [statutory requirements](#)), providing accessible funds if the contractor goes under. However, retention amounts are typically insufficient to cover the shortfalls arising from a contractor insolvency, and setting retentions too high could cause cash-flow difficulties for a contractor. To manage insolvency risks, retentions should be supplemented with additional forms of security.

Performance bonds

Performance bonds provide a project owner with access to cash to cover the shortfalls arising from a contractor insolvency (as well as being used for other circumstances that may arise). Bonds are a financial product provided by a bank or insurance company, that can provide a useful form of 'insurance' against insolvency risks. However, bonds have a cost and are only as good as their providers. The ideal is a truly 'on-demand' performance bond from a registered, highly-rated, reputable (and preferably local) bank or financial institution.

If a contractor is unable to obtain bond facilities, that can be an early indicator that the contractor is overstretched or in difficulty.

Advance payment bonds

Payment for materials in advance is a practical way to enable early procurement of those materials to mitigate inflation risks and the risk of late delivery of materials to site. However, without the right contractual requirements in place, such payments can be lost if the contractor becomes insolvent.

Advance payment bonds commonly mirror the advance payments, and enable a project owner to recoup its advance payments upon contractor default.

Registering rights to materials

The Personal Property Securities Act 1999 (PPSA) enables a project owner to register its interests in materials, protecting those materials from liquidators and general creditors.

This is a cost effective way of enabling materials to be recovered upon contractor insolvency. However, it requires particular contract provisions regarding title and security interests, and only works if project managers are diligent in registering such interests on the applicable register.

The safety net: how to save a project from a falling contractor (Continued)

Parent company guarantees

Sometimes an individual company can fail while the remainder of the group carries on. If the proposed contractor on the project is a subsidiary of a wider group, project owners can require a guarantee that if the subsidiary fails, the group will step in to finish the job.

Parent company guarantees can either be incorporated into your construction contract directly or set up as a separate guarantee.

Subcontractor continuity guarantees

The collapse of a contractor can have a domino effect: there are usually unpaid subcontractors who are no longer contractually tied to the project.

Subcontractor continuity guarantees are a side-agreement between the project owner and key subcontractors, from the outset of the project, that enables the project owner to keep paying the subcontractor if the subcontractor keeps working. This is an effective way of ensuring continuity.

Intellectual property rights

If a proprietary technology is essential to the project (for example, patented equipment or complex operating software), or if the design is owned by the contractor, there can be risks to the project if the party providing that equipment or design ceases to exist.

Ensuring that the project owner has appropriate intellectual property rights, and contingent rights in the event of an insolvency (for example, contingent access to native format design information or software source code), is essential to being able to continue the project, or operate and maintain equipment in the long-term, in the event of insolvency of a key provider.

Strategies and rights for securing the site

If a contractor goes under, it's important to quickly secure the site and the materials that are often stored there. Achieving this requires a contract that gives the project owner the right to take possession of the site, and a plan to give effect to that right if the worst happens.

Want to know more?

If you have any questions about managing insolvency risks in construction projects, please contact [Lauren Whitehead](#), or [Steve O'Dea](#) from our specialist [Construction Team](#). If you have questions about an insolvency that is imminent or already underway, our specialist [Insolvency and Restructuring Team](#) is also able to help.