



CONSTRUCTION BUSINESS RECOVERY

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Recovery News

Why hasn't Quantitative Easing (QE) helped Haymills?

With specific reference to the construction industry the administration of Main Contractor Haymills stands in stark contrast to recent suggestions by some economic commentators that the UK economy is slowly beginning to see some rays of light shining through gloomy, dark clouds.

The prospects for Haymills looked bleak after their bankers decided that they could no longer continue to support the Main Contractor's overdraft. This action brought cries of foul from a company's spokesman, quoted as saying:

"RBS moved the goalposts and knocked the wind out of us. It was in the same week that I read a five-page article in the Mail on Sunday about how it was helping small and medium-sized businesses. Don't believe everything you read in the papers, clearly."

Perhaps there are two views to take on this matter. One legitimate view could be that banks have simply stopped extending credit to companies that should never have been extended such high levels of credit in the first instance. With respect to construction this follows the point of view that that Main Contractors, who hold cash from employers to distribute to sub-contractors, shouldn't have to rely on ballooning overdrafts to fund their operations.

Alternatively, you could argue the government support provided to Banks should serve to oil the wheels of the 'real' economy.

As a result cash, (According to Lord Dennings 'the life blood of the industry')² should be pumping round the construction industry

1 Bill, T, Vinci Poised to buy Haymills, Building 11 August '09
2 Dawneys Ltd. v. F.G. Minter Ltd. and Trollope & Colls Ltd. [1971] 1 W.L.R.

supporting viable firms as opposed to repairing Banks' damaged balance sheets.

It has been argued that one reason why the real economy has continued to suffer in the face of lowered interest rates and quantitative easing is due to apparently contradictory policies from the government and the FSA.

The former states that banks should maintain lending to profitable firms, whilst the latter demands that banks should hold more capital against their loan book. This begs the question: Which one of these policy directives should be followed?

Haymills and many other contracting organisations is sure to have an opinion on this matter.

Many within the construction industry may be wondering why the Government doesn't fund the 'real' economy directly? This becomes an especially pertinent question against the backdrop of the reluctance by Banks to increase lending, preferring instead to rebuild bruised balance sheets. Options include increased construction spending and / or measures to reduce the tax burden on already stretched construction companies. At least until the worst is over.

In a world of budget deficits, proposed spending cuts and talk of increased taxes to rebuild public finances this is ultimately as much a political as an economic question. Only time will tell.

Notwithstanding the view one may favour, there seems to be little doubt that QE and its long term effects is here to stay as the BoE recently prescribed another £50bn of steroid for the British economy.

However, the effect that this will have on the real economy and the construction industry in particular remains to be seen.

It seems inevitable that the hangover from low construction spending in 2008/09 will eat away at construction companies' balance sheets and

lead to a deluge of insolvencies later in the economic cycle.

To 'set-off' or not to 'set-off'?

With increasing levels of contractor insolvency being but one unfortunate reality in our recessionary world, many construction clients may be faced with incomplete projects. Often they face substantial additional costs to complete these projects.

As a result many Insolvency Practitioners - grappling with the idiosyncrasies of contractor insolvency - will be confronted by such clients purporting to have set-off the claims of the insolvent contractor against monies otherwise due to the client body.

This article therefore considers the topic of set-off as it applies to claims against a contractor and set-off against balances owed or claims for work completed.

For the purposes of this article, set-off has been divided into two categories:

- Pre Insolvency set-off
- Post Insolvency set-off

Pre Insolvency Set-Off

Pre Insolvency set-off can consist of the following:

1. Contractual Set-off
2. Legal Set-off
3. Equitable Set-off
4. Banker's right of Set-off

Therefore, we will discuss each of the above types of set-off in turn.

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Contractual Set-off³

The general position is that a certified sum is not insulated from set-off unless the contract explicitly provides otherwise.

In essence contractual set-off creates a set-off mechanism where none existed before and where the contract amends common law remedies. A contract therefore could:

- o Allow set-off of unliquidated cross-claims arising from unrelated contracts or unconnected claims
- o Confer express rights of deduction i.e. retention
- o Allow parties the ability to exercise group set-off

Most construction contracts will therefore include a specific mechanism for set-off which should be carefully scrutinised.

Legal Set-off

- o Applicable where the claims on both sides were liquidated debts or money demands which could be ascertained with certainty at the time of pleading. *B Hargreaves Ltd. v Action 2000 Ltd.* (1992) 62 BLR 72 CA
- o If not liquidated the quantum of claims must be easily ascertainable without estimation or valuation
- o Only available in judicial proceedings (not arbitration or adjudication)
- o Legal set-off is only a defensive right

Equitable Set-off

Sometimes this form of set-off is also referred to as 'transaction' set-off. It tends to be valid where the two claims are so intrinsically (inseparably) linked that it would be unjust to allow one to proceed without setting-off the other – irrespective of whether they are liquidated or unliquidated.

Banker's Right of Set-off

This is where a customer to the Bank has more than one account with his bank. A Bank can only invoke banker's set-off if certain conditions are met. These include that the respective accounts should be held in the name of the same legal entity (and in the same capacity) in addition to the debt being due and payable.

Note: Inevitably, Banks will always attempt to extend their rights of set-off by making explicit contractual provisions for the same.

Post Insolvency Set-off

Insolvency Set-off

- o Statutes provide a right of set-off in respect of mutual debt provisions on bankruptcy and liquidation. However, this set-off does not extend to Administration.
- o Section 323 – Insolvency Act 1986 (Mutual credit and set-off bankruptcy)
- o Rule 4.90 – Insolvency Rule 1986 (mutual credit and set-off in liquidation)

³ Davis, R.; Construction Insolvency: Security, Risk and Renewal in Construction Contracts; Sweet & Maxwell; 2008

Section 323

This section applies where - before the commencement of the bankruptcy - there have been mutual credits, mutual debts or other mutual dealings between the bankrupt and any creditor of the bankrupt proving or claiming to prove of bankruptcy debt.

An account shall be taken of what is due from each party to the other in respect of the mutual dealings and the sums due from the other.

Rule 4.90 adopts substantially the same wording.

Set-off is applicable in liquidation where it is mandatory and automatic on the winding up of the company.

In a summary, does set-off apply?

In Administration: The entry into administration has no effect on the parties' right of set-off with respect to equitable or contractual set-off.

With respect to legal set-off it is argued that it applies only to money claims which are enforceable by action. Since actions against a company in administration cannot be brought without the consent of the administrator or leave of the court it cannot be used in this situation.

In Liquidation: Where one of the contracting parties goes into liquidation, the general law or parties own contractual set-off arrangements are replaced by a mandatory set-off applied by r.4.90 of the Insolvency Rules and further clarified in *Bouygues v Dahl-Jensen* [2000] B.L.R. 522 :

- o Before the company goes into liquidation there have been mutual credits, debts or other mutual dealings between company and creditor proving debt in liquidation
- o An account taken of what is due as a result of mutual dealings and sums due to be set-off against each other
- o Sum regarded due irrespective of whether it is payable at present or in future; obligation is certain or contingent; amount is fixed or liquidated; or whether ascertainable by fixed rules or opinion

In a Company Voluntary Arrangement (CVA):

A company in Voluntary Arrangement can expressly modify the common law rights of set-off.

However, a debtor taking assignment from a creditor (in order to improve its position) after an agreement has been sanctioned, would probably not be able to set-off its debt against the assigned credit since the latter would be subject to the terms of the arrangement.

In Administrative Receivership: Not discussed here given its decline as a formal insolvency procedure.

What about the *Pari Passu* principle?

The general principle is that unsecured creditors should be paid *pari passu*, i.e. equally in accordance with the value of their debt.

However, insolvency set-off constitutes an exception to this general principle. The idea is that this does justice to the creditor so that he does not have to pay a defaulting debtor in full while himself only receiving a dividend.

CBR Team News

Bond seminar a sell-out

Over 100 clients flocked to a recent Construction Bonds and Guarantees themed seminar in MidCity Place earlier this summer.

The breakfast session was held twice due to high demand from organisations including the major banks and many accountancy firms. Even then demand outstripped capacity. Each session was co-chaired by Barry Higgs, who heads the Surety Advisory Unit at Davis Langdon and co-hosted by Dundas & Wilson.

'There is still a great deal of misunderstanding around Bonds and Guarantees - particularly in response to the insolvency of the bonded contractor,' Barry states, 'there is also an increasing appreciation of their value in tough market conditions.'

'Our ability to deliver really practical advice through this seminar is a great demonstration of how Davis Langdon can engage and support clients during the economic crisis. To have had such high attendance and great feedback is particularly pleasing.'

There are now plans to hold the seminar in multiple locations around the country. Please contact Sharon Madden at MidCity Place on +44 (0) 207 061 7066 for further information.

If anyone would like a copy of the presentations, please contact Lorraine Morley at MidCity Place on +44 (0) 207 061 7181.