

Procurement white paper conference

Distressed contractors

What are the warning signs of a contractor in financial distress? What can you actively do to ensure that your service is continued and delivered within the rules?

Tom Hutchison, 16 May 2019



Freshfields Bruckhaus Deringer

Warning signs to watch for



Milestones
are being missed



The Contractor is
withdrawing its
workforce



Plant and equipment are
disappearing from the
site or are arriving more
slowly/in lower volumes



Sub-contractors
and suppliers
are not being paid



Sub-contractors, suppliers
and third parties are
making
claims/commencing
adjudications



Other projects
involving the Contractor
are in delay



Profit warnings,
sliding share price
or announcements
of appointment of
financial advisors,
increasing debt
yields, ratings
downgrades

Keeping the project on track

Three possible routes to keep the project on track

- Continue with the existing contractor if they are in administration and likely to trade out or to be restructured
- Contract directly with your supply chain
- Appoint an alternate prime contractor/construction manager

Practical factors that influence your choice

- What expertise do you have in house to manage the project?
- What stage has the project reached at the point of insolvency?
- How well established is the supply chain?
- How much work is being undertaken by the supply chain as opposed to the prime contractor?
- What level of risk are you willing to take?
- Public procurement considerations: how do you stay within the rules?

Public procurement tender rules

Is the contract caught by the public procurement regime?

General rule is that substituting a new contractual partner is a material change which will constitute an illegal direct award of a new contract and so require a new tender

Unless caught by one of the:

- Permitted categories of changes to existing contracts
- Exemptions from tendering

Remain with the same/ restructured contractor

Potential to stay with 'same' contractor if it becomes a new 'Good Co' following restructuring or can trade out of administration

What does the contract say regarding insolvency events?

- Automatic termination or a right to terminate?

Contracting with Good Co expressly permitted by Reg. 72(1)(d)(ii) subject to:

- The replacement contractor fulfilling the original selection criteria; and
- There being no other material changes to the contract (e.g. price, scope or apportionment of risk)

Reg. 72(1)(d)(ii):

“where a new contractor replaces the one to which the contracting authority had initially awarded the contract as a consequence of universal or partial succession into the position of the initial contractor, following corporate restructuring, including takeover, merger, acquisition or insolvency, of another economic operator that fulfils the criteria for qualitative selection initially established, provided that this does not entail other substantial modifications to the contract and is not aimed at circumventing the application of this Part”

Issues to consider:

Are there certain financial security / covenants / bonds required to satisfy the original selection criteria?

Assignment to a new contractor

Contracting authority generally not permitted to assign to a new contractor though the contractor may be able to

What does the contract say?

- Does the contract permit assignment by the contractor?
- What veto rights does the contracting authority have?
- Is there an unequivocal review clause or option in the initial procurement documents?

Permitted by Reg. 72(1)(d)(i) provided that:

- The clause states the scope and nature of the option and when it may be used; and
- It does not alter the overall nature of the contract

Reg. 71(2)(d)(i):

“where a new contractor replaces the one to which the contracting authority had initially awarded the contract as a consequence of an unequivocal review clause or option in conformity with [Reg.72(1)(a)]”

Issues to consider:

Will the new contractor adopt the work undertaken to date? Does the balance of project risk change?

Assignment to a new contractor

Is the new contractor a member of a framework agreement?

- Likely to be permitted since already advertised, however this depends on the conditions of competition of the framework
- Typically the framework would not envisage the specific contract in question – rather for the general needs of the contracting authority in respect of classes of services
- Need to consider the specific terms of the contract

The contract does not provide for the replacement of the contractor

- This is not expressly permitted by the PCR 2015
- Assessing risk of a successful challenge:
 - Does the replacement contractor fulfil the original criteria for selection? E.g. did it compete in the competition, such as the second ranked bidder?
 - Are there any other material changes to the contract? E.g. replacement contractor accepts novation of contract and supply chain or replacement contractor does not accept full risk on entire scope of original contract

Contracting authority steps-in/ takes over the supply chain

What does the contract say?

- If the contracting authority has a step-in right (either in the main contract or subcontract by way of collateral warranty) then it is permitted by Reg. 72(1)(d)(i) provided that:
 - The clause states the scope and nature of the step-in and when it may be used; and
 - It does not alter the overall nature of the contract

The contracting authority does not have a step-in right and contracts directly

- New contracts with existing sub-contractors will constitute new “public contracts” under the PCR (if above the thresholds and subject to exemptions – see below) and must be advertised
- Note this is expressly envisaged by Article 72(d)(iii) Directive 2014/24/EU but was not provided for in Reg. 72 PCR 2015

Reg. 72(1)(d)(i):

“where a new contractor replaces the one to which the contracting authority had initially awarded the contract as a consequence of an unequivocal review clause or option in conformity with [Reg.72(1)(a)]”

Issues to consider:

Is it in the best interests of the project for the authority to step-in?
Does the authority have the necessary experience, capability and capacity to manage the contracts? Are they willing to accept the risk of doing so?

One member of a JV contractor goes insolvent

Corporate JV – one parent shareholder goes insolvent:

- What do the contract/tender documents say?
 - *MT Hojgaard A/S v Banedanmark* – application after bid-phase?
 - JV Co must still be able to meet the requirements initially laid down by the contracting authority and must not put other tenderers at a disadvantage
 - There should be no other material changes to the contract
- Breach of other provisions:
 - Change of control?
 - Security/PCGs?
- If JV Co is restructured down the line then Reg. 72(1)(d)(ii) may apply

Contractual JV – insolvent company is one of the contracting parties:

- What do the contract/tender documents say?
 - Joint and several liability?
 - Security PCGs
- Replacement of contracting party:
 - Restructured ‘Good Co’
 - Assignment to a new contractor?

Issues to consider:

A new contract for a reduced scope (where the majority of the work is complete or the remaining contractor’s capabilities do not extend to the full scope) could amount to a material modification – *Finn Frogne*

Note: consider whether there are competition law considerations

Other ways to stay within the rules/mitigate risk of challenge

Reg. 32(c) – Award using negotiated procedure without prior publication due to reasons of extreme urgency brought about by unforeseeable events?

- Strictly interpreted
- Was the insolvency unforeseeable?
- What factors must be considered to place a contract on an emergency basis?

VEAT notice

- Reg. 99(3)(b)
- Contracting authority considered the award of the contract without advertising was permitted
- Protection against a declaration of ineffectiveness
 - Standstill period 10 days
 - Collateral agreement to address consequences of an order of ineffectiveness
- Is a considered but mistaken belief sufficient?
- A contract award notice issued after the event shortens the period to claim ineffectiveness from 6 months to 30 days

Thank you

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