

Insights

A CRASH-COURSE GUIDE TO NAVIGATING INSOLVENCY IN CONSTRUCTION SUPPLY CHAINS

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Summary

With the ever present issues of price escalation, availability of materials and the general state of the world, it seems timely to address some of the key issues in dealing with insolvencies in the construction supply chain. Whilst lawyers are often accused of being 'doomsday preppers', according to the Insolvency Service the total number of construction firms becoming insolvent in the 12 months to March 2026 was 3,827. This article pulls together a crash course list of key issues to consider where there may be insolvency in your construction supply chain through the lens of the employer.

Insolvency red flags

Like smoke from a kitchen that the chef insists is just steam, here are some signs that a contractor might be insolvent, or is at risk of becoming insolvent:

- Always monitor the financial performance of a contractor. Watch out for persistent rumours in market about a contractor's financial position (in the press or from other sources). Even the largest of contractors are not immune from solvency issues.
- Be aware of what's happening on the ground. For example, the contractor's employees or sub-contractors not turning up to work, a decrease in the number of workers on site or volume of materials being delivered, a slowdown in the progress of the works, rumours or complaints that sub-contractors are not being paid (or being paid late) are all red flags.
- Is the contractor seeking to negotiate further payments, seemingly unreasonable additions to the contract sum, early release of retention, or changes in payment patterns?
- Has there been a recent change in the contractor's behaviour? For example, increasing aggressiveness about being paid or conversely, evasiveness in communications?

- Is the contractor having problems procuring insurance or bonds (such as those for off-site materials)?
- Has the contractor assigned (or has it sought the employer's consent to assign) the building contract to a bank or other creditor?
- Is there a late filing of accounts or annual returns at Companies House, or are auditor's reports signed off subject to a qualification?
- Are there unsatisfied court judgements against the contractor?
- Pay attention to group companies / the parent company of the contractor displaying the same signs as noted above. Often insolvency occurs to a whole group of companies rather than just the single contractor entity.

While the above is not conclusive, they are warning signs that suggest a contractor might be facing financial difficulty.

Suspicious confirmed: steps to take

Generally, the playbook of what an employer is entitled to do in a contractor insolvency scenario is governed by the terms of the building contract.

The first step to consider is whether a contractor is 'Insolvent' as defined under the building contract. For example, the JCT D&B 2024 edition sets out a detailed list of when a company becomes 'Insolvent'. An employer cannot rely on the relevant terms of the building contract simply because there is a potential insolvency or in anticipation of insolvency and the consequences to the employer for 'going early' could be significant.

Provided the contractor meets the test for 'Insolvency' under the building contract, there are a few things it may be entitled to do.

Cease payment

An employer won't want to pour water into a leaking bucket and keep paying the insolvent contractor. Typically the building contract will provide that it doesn't have to, for example, under the JCT D&B 2024 edition, from the date a contractor becomes 'Insolvent', no further sum will become due to the contractor, and the employer is not required to pay any sum that has already become due, provided that the employer has given a pay less notice (or the contractor becomes insolvent after the last date for giving a pay less notice). It goes without saying but before stopping payments, employers should check what their building contract provides in this scenario and make sure they comply with it.

Sub-contractors – to pay or not to pay?

In the construction industry, time is money, and an employer will want to keep the project moving despite the main contractor becoming insolvent. At face value, an employer might think the next logical step is to directly pay sub-contractors to keep works progressing on site. However, employers need to tread carefully as building contracts generally don't entitle (or oblige) the employer to pay sub-contractors directly unless they have been expressly amended to do so.

Without contractual provision, the danger of paying a sub-contractor directly is that this could be deemed as a preferential payment under insolvency law. Preference in insolvency law occurs when a particular creditor (being a sub-contractor) is placed in a more beneficial position to the detriment of the remaining creditors in that class. These transactions can become voidable as they offend the 'pari passu' rule in insolvency.

The other issue is that the contractor might still be entitled to payment for that work, requiring the employer to pay twice. Unless contractually provided otherwise, any payments made directly by the employer to sub-contractors will not reduce any liability the employer has to the main contractor for the same work. If direct payments are agreed with a sub-contractor, a prudent employer should seek the sub-contractor's agreement that such payments are backed by an indemnity requiring the sub-contractor to re-pay monies if they were ever clawed back on behalf of the insolvent contractor.

Performance security – how useful is it?

It is standard practice for a contractor's obligations under a building contract to be backed by a security package in the form of a performance bond and/or a parent company guarantee. However, where a contractor becomes insolvent, quite often the solvency issues run up the chain and the parent company is also in trouble. In such cases, the parent company guarantee might serve better use as wallpaper.

While performance bonds are also commonplace, they are often only provided for a value equal to 10% of the contract sum, a value that in most cases would not be enough to cover any costs or losses suffered by the employer due to contractor insolvency. Typically they also usually work on an 'on default' basis which means that the employer will need to demonstrate the losses it has suffered due to the contractor's breach or insolvency before being able to claim under the bond.

Utilising step-in

Sub-contractor collateral warranties should allow for employers to step-in to the main contractor's shoes under the sub-contract. For this reason the employer should push for delivery of any sub-contractor warranties it is entitled to as early as possible in the construction phase rather than, as is often the case, leaving these until the end of the project.

The unamended JCT D&B 2024 edition requires that the contractor must include a provision in sub-contracts that provides the sub-contractor's employment under the sub-contract shall terminate

immediately upon termination of the contractor's employment (subject to certain caveats around third party rights / collateral warranties already provided). This is not helpful in an insolvency scenario if the employer requires step-in rights so employers may want to consider amending the standard JCT position.

However, if step-in isn't an option, there are other ways for the employer to take control of sub-contracts such as entering into new contracts with the sub-contractors which incorporate the terms of their sub-contracts with the contractor.

Secure the site and materials

Securing the site is paramount so that unpaid creditors with sticky fingers can't attempt to take any valuable materials from the site in lieu of payment.

Issues can arise in relation to materials not yet incorporated into the works. Who holds the title in unfixed materials depends on what the building contract says. Some building contracts say title passes when payment is made for them, others say title passes when they are delivered to the site. If the insolvent contractor hasn't paid its supplier for the materials, then title may still rest in the supplier (even if the employer has paid the contractor for it).

If an employer has materials delivered to site, it should ensure they are quickly affixed to the site to be incorporated into the works. If payment is being sought for unfixed materials (especially prior to delivery to the site), the employer should seek a bond for the value of the unfixed materials.

Warranty package

Where a contractor is appointed on a design and build basis, an employer will have the benefit of calling on the contractor's design and construction liability wrapper (as it takes a single point design and construction responsibility). Persuading a replacement contractor to accept full design and construction responsibility for a part-completed project can be challenging depending on the stage of the project and the identity of the parties, but without this the employer loses the single point responsibility.

In the absence of a contractor providing the design and construction liability wrapper, an employer must ensure that it plugs any gaps in the warranty package (ie procure any missing collateral warranties or third party rights from sub-contractors and sub-consultants). The benefit is twofold. The first is that the employer will at least have recourse from sub-contractors and sub-consultants in the event of a defect which has not be wrapped by the replacement contractor. The second is that this will make the project more marketable to any potential third parties in the future in a sale scenario.

Termination of the building contract?

If an employer wishes to terminate the building contract, it must first consider whether the contract allows for it. The insolvency of one party does not automatically permit the other to terminate – there must be an express right to terminate. A party also (as noted above) cannot terminate in anticipation of insolvency.

Provided the contractor meets the contractual definition of 'Insolvent', the building contract may prescribe the steps required for the employer to terminate (in some instances termination may occur automatically). An employer must strictly follow the steps set out in the building contract. Failure to do so may result in a repudiatory breach on the part of the employer, which may open the employer up to a whole host of claims such as a claim for loss of profit damages.

Consideration should also be given to whether any third party agreements prescribe requirements before a building contract is terminated (for example, a facility agreement requiring funder consent to terminate).

There is also the option *not* to terminate. Under the JCT D&B 2024 edition, a contractor's obligations are automatically suspended when it becomes 'Insolvent'. The contract still being 'on foot' entitles the employer to enforce it as necessary (for example to procure collateral warranties or to deliver up contractor designed documents), although this will require the co-operation of the insolvency practitioner. The parties may also agree to novate the building contract to an incoming contractor (although careful consideration must be given to this where the contractor is going through a formal insolvency process as, for example, a liquidator may have the power to disclaim an unprofitable contract). Bringing in a replacement contractor while the original building contract is still on foot may also amount to a repudiatory breach by the employer.

Completing the project

Ultimately an employer wants to complete the project. Generally there are two main options: (1) appointing a replacement main contractor and (2) procuring the works on a construction management basis.

If taking the first option, as discussed above, a replacement contractor may be reluctant to agree to a design and construction wrapper for the works completed by the insolvent contractor. However, the attraction of this option is that an experienced, prudent contractor is taking over the works and can adopt and administer the existing sub-contractors (provided the sub-contracts allow for it). This is beneficial in scenarios where the employer is not an experienced and/or internally well-resourced developer.

If taking the second option, this may be more cost effective for an employer as appointing a construction manager is usually cheaper than appointing a replacement contractor in respect of fees payable. However, procuring works on a construction management basis places a large administrative burden on the employer, and would also require amending the sub-contracts to be

trade contracts. It also means the employer no longer has the benefit of a single point design and construction wrapper for the completed works.

There is a third option in that an insolvency practitioner appointed to the insolvent contractor may agree to complete the project (provided the employer waives its rights to terminate for insolvency), however this is rare unless the project is very close to completion.

Insurance

If employers have concerns about contractor covenant strength at the start of a project it would be worth investigating taking out a latent defects insurance policy for the works. In the absence of a main contractor, such a policy would provide some recourse for the employer in relation to defects within certain elements of the works, such as the structure and waterproofing.

Final thoughts

This is a tricky area for employers to navigate – there is no ‘well-trodden’ path for insolvencies in the construction supply chain. Our crash course guide set out in this article should provide some helpful signposts to guide employers along the way in this complicated area of law.

In summary:

- Keep your finger on the pulse and be aware of what is happening on the ground. Where there is smoke, there is usually fire.
- Act early if there are any suspicions, for example by pushing for the delivery of all outstanding sub-contractor collateral warranties. Take stock of what you have (eg performance bonds), and what you might need (eg collateral warranties, delivery of off-site materials).
- Be sure to pay attention to the terms of your building contract – each one is different and will provide for different rights and obligations.
- If the contractor becomes insolvent, carefully consider the next steps. Do you want to step-in and complete the project, or is it more appropriate to employ a replacement contractor? Consider seeking specialist advice in this respect.

Related Capabilities

- Commercial Construction

Meet The Team



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