

Construction and development surviving the recession

Richard Wade
Partner, Head of Construction

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This afternoon's speakers and topics

- Richard Wade - industry overview
- Theo Anderton - insolvency and recovery
- Peter Wilson - investigations

Overview

- Forecast/Outlook (CPA)
- Lessons from the last recession
- Changes to the Construction Act
- What parts do the public sector and the funders have to play in assisting the industry in the current climate?

Forecasts for construction

- Continuing prospect of economic deterioration
- Slower private housing and commercial property markets
- Government's investment plans (Comprehensive Spending Review)
- Public sector output to grow
- Improved prospects for infrastructure sector
- General housing market slowing down significantly
- Office construction prospects deteriorating
- Vulnerable to protracted problems in financial markets

CPA Report – autumn 2008

- Construction output to decline by 7% in next 3 years – return to growth in 2011 at earliest
- Housing starts in 2012 will be below 2007 levels
- Fewest private housing starts in 60 years
- “dramatic fall” in industrial buildings; future prospects for commercial development “exceedingly poor”

CPA Report – autumn 2008

- Follows unprecedented growth (32% from 1994 to 2007)
- Public sector spending continues to increase
- Immediate future for education, health facilities and transport infrastructure continues to be positive but ...
- With weak public finances, position after 2010 expected to worsen

“These forecasts are without doubt the gloomiest we have produced since compiling this information and have been downgraded from just three months ago to show the sharpest downturn since 1991. The prospects for the industry over the next few years are very precarious. Therefore it is critically important that the government maintains its spending plans in order to deliver the much needed investment in our schools, hospitals, infrastructure and other public sector investment.”

- Michael Ankers, Chief Executive, CPA

A short history lesson ...

- Sir Michael Latham *Constructing the Team* (1994)
- 30 recommendations made; 2 so far adopted (adjudication and payment)
- Implementation of Housing Grants (Construction and Regeneration) Act 1996
- Review of 1996 Act by BERR; amendments likely to be implemented in 2009
- Some limited adoption of other recommendations (such as project bank accounts)

A short history lesson (Part 2)

- Sir John Egan; *Re-thinking Construction* (1998)
- Emphasis on collaborative working
- Prompted change and emphasis in procurement especially on public sector projects (approach of OGC in using NEC as a contract of choice)

Key recommendations

- The Government (and public sector clients) should take the lead in terms of being a model of client best practice
- Highlighted by Latham as being inherent requirement but one which is accentuated in times of economic difficulty

The Construction Act 1996

- 2 key recommendations of Latham
- Introduction of mandatory provisions for payment and dispute resolution via adjudication
- 2 perceived effects:-
 - Improved cashflow (including outlawing of “pay when paid” clauses)
 - Quicker and cheaper means of resolving disputes
 - But
- Never ‘recession tested’

The Construction Act 2009 ...?

- Proposals to amend the 1996 Act
- Included in Queen's Speech, December 2008
- Provisions contained in Part 8 (Construction Contracts) of the LDED
- Possibly significant amendments to provisions for payment and adjudication

Proposed Construction Act amendments (1)

Payment

- Prohibition of “pay when certified” (section 110)
- Introduction of “payee notice” (section 110A/B)
- Overhaul of withholding notices – requirement to pay “notified sum” (section 111)

Proposed Construction Act amendments (2)

Adjudication

- Removal of section 107 (requirement for contract to be in writing) but ...
- New requirement for adjudication provisions to be in writing (section 108)
- Stipulations about costs and fees - including outlawing of “*Tolent*” clauses (sections 108A/B/C)

The funders

- Public sector funders
- Private sector funders
- Attitude to risk
- A funding gap?

The funders' approach (1)

- Banks still lending in the construction/development sector (although with greater caution)
- CBI exhorting banks to step up lending given large numbers of businesses requiring refinancing
- Existing loan agreements being honoured but little evidence of fresh lending
- Signs of banks making losses on commercial property loans

The funders' approach (2)

- Public sector spending pressing ahead
- Limiting of 'loan to value'
 - 50%-60% (commercial)
 - 50%-65% (residential)
- Commercial developments must have benefit of agreement (to lease or purchase) at the time of development
- No funding of speculative development if no tenant/purchaser
- Loans based on LIBOR only; no base rate loans
- Increased margins due to less liquidity/more regulation

A summary of the landscape

- Have lessons been learnt?
- Remember Latham; will public sector provide clients exhibiting 'best practice'?
- Landscape of procurement has changed but ...
- ... will this translate to more collaboration (and fewer disputes) in a downturn?
- The role of 'ADR' could be key

Surviving the recession

Theo Anderton
Partner, Insolvency and Business Recovery

DDI: 020 7814 6916

Email: theo.anderton@bllaw.co.uk





Insolvencies are on the rise

- Number of personal and corporate insolvencies soar in last quarter of 2008

Numbers predicted to rise further in 2009



What is insolvency?

- When an individual or a corporate entity:
 - is unable to pay his/its debts as and when they fall due (cash-flow insolvency) or
 - has insufficient assets to cover their liabilities (balance sheet insolvency)

Types of personal insolvency

- Bankruptcy
- Individual Voluntary Arrangement (IVA)

Types of corporate insolvency

- Liquidation
 - compulsory
 - voluntary
- Administration
- Administrative Receivership
- Company Voluntary Arrangement (CVA)

Role of the insolvency practitioner

- Contrary to popular belief.....



Main Con Limited – in administration



Main Con Limited – in administration (1)

Employer  Administrator  Subcontractor

Main Con Limited – in administration (2)

- The contractual position



Main Con Limited – in administration (3)

- Meaning of Insolvency
- 8.1 For the purposes of these conditions, a party is insolvent if:
 - .1 he enters into an arrangement, compromise...
 - .2 without a declaration of solvency, he passes a resolution or makes a determination that he be wound up...
 - .3 he has a winding up order or bankruptcy order made against him
 - .4 he has appointed to him an administrator or administrative receiver
 - .5 he is the subject of any analogous arrangement, event or proceedings in any other jurisdiction
 - .6 9 (additionally, and in the case of a partnership) each partner is the subject of an individual arrangement or any other event or proceedings referred to in clauses 8.1.1 to 8.1.5

Main Con Limited – in administration (4)

- Employer has very wide ranging rights

Employ and pay others (8.7.1)

Take possession of the site and works and use all temporary buildings, plant, tools, equipment and site materials (8.7.1)

Requirements for further payments and/or release of retentions cease to apply (8.7.3)

Main Con Limited – in administration (5)

- The Site
- Use of plant and equipment
 - *Smith (Administrator of Coslett (Contractors) Limited) v Bridgend County Borough Council [2000]*

Main Con Limited – in administration (6)

- The payment position



Main Con Limited – in administration (7)

- Cease payments until advice
- Rights of set-off (contract or operation of law on insolvency)
- *Melville Dundas Limited (in receivership) v George Wimpey UK Limited [2007] UKHL 18*

Main Con Limited – in administration (8)

- Retentions
- Escrow accounts
- Guarantees/securities
- ROT

Main Con Limited – in administration (9)

- Avoidance of prior transactions and other claims by insolvency practitioners

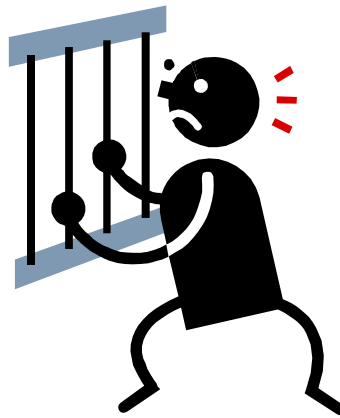
Possible IP claims (1)

Direct payments

*British Eagle International Airlines Limited v
Compagnie Nationale Air France [1975]*

Possible IP claims (2)

- Directors' duties
- *In the matter of Uno plc and World of Leather plc [2004]*



Be prepared...

- Look for warning signs
- Seek advice
- Make plans



The best laid plans.....

*Action Strength Limited (t/a Vital Resources) v
International Glass Engineering IN GL EN SPA
[2003] UKHL 17*

Investigations in a recession

Peter Wilson, partner

Agenda

- Heightened risks in recessionary times
- Who could be after you?
- Planning as prevention
- Dealing with raids and searches – top tips!
- Post trauma



Fraud risks in a recession

- Overhead review reveals existing undetected problems
- Bribery of customers
- Insolvent customers extracting advance payments
- Hard pressed executives over claiming expenses, diverting stock, accepting bribes
- 'Creation' of trade with false purchase/sales invoices
- Extractions of cash or assets
- Use of cheap illegal labour
- Hiding true financial position to extend bank support
- Debtors giving false picture on their finances

The Bribe Payer's Index*

■ Construction	5,2	■ Telecommunications	6,6
■ Real estate	5,7	■ Transport & storage	6,6
■ Oil & gas	5,9	■ Arms & defence	6,7
■ Heavy manuf.	6,0	■ Hotels, Rest. & Leisure	6,7
■ Mining	6,0	■ Agriculture	6,9
■ Pharmaceutical	6,2	■ Light manufacturing	6,9
■ Utilities	6,3	■ Information technology	7,0
■ Civilian aerospace	6,4	■ Banking & finance	7,1
■ Power	6,4	■ Fisheries	7,1
■ Forestry	6,5		

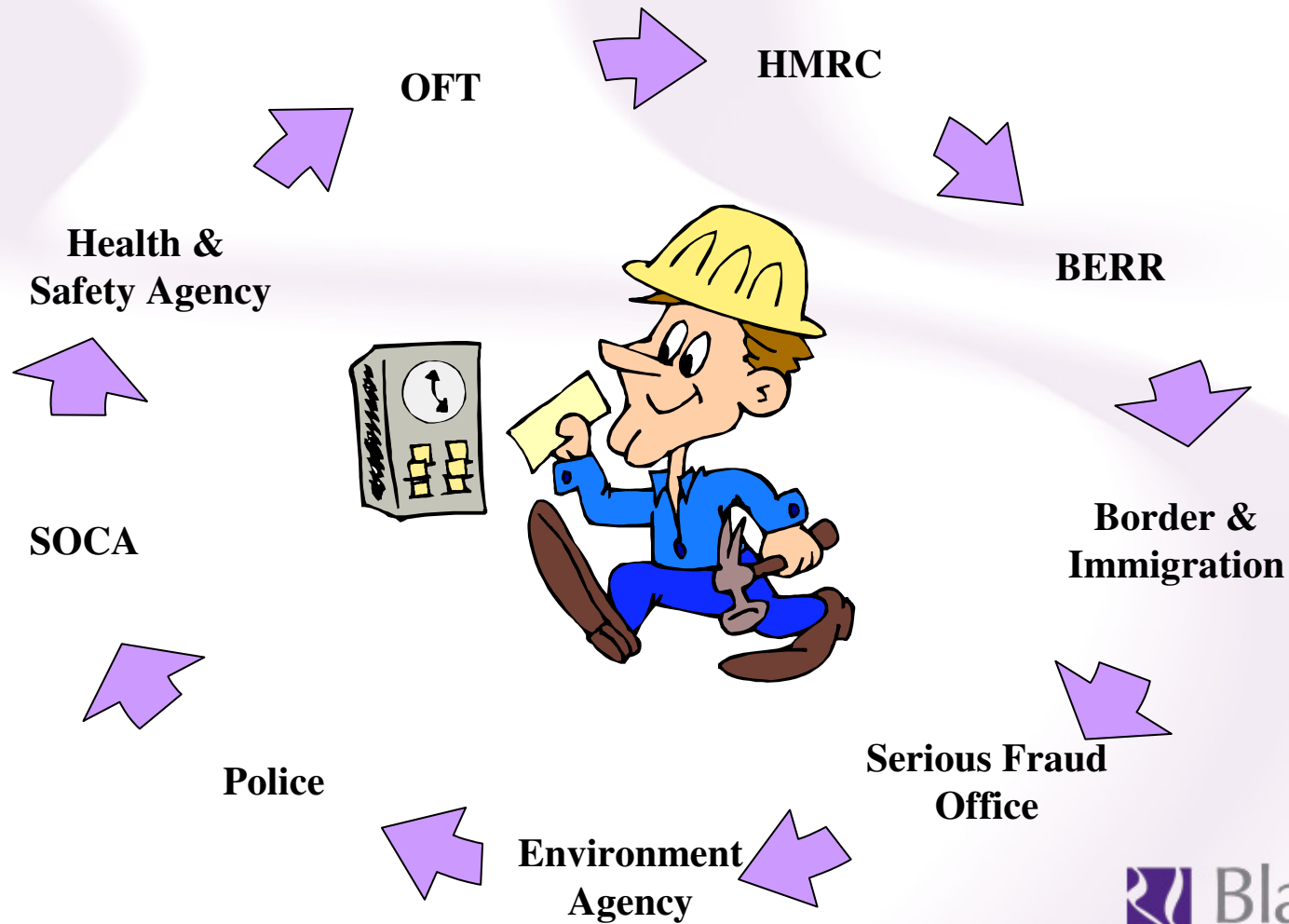
* Transparency International

Other indicators

- Construct & Engineering - second highest level of fraud of any industry*
- CIS tax scheme now bedded in and enforcement will increase
- HMRC Labour Providers Unit set up
- HMRC new investigation powers
- Immigration from non EU member states tougher
- New National Fraud Strategic Authority
- OFT drive against price fixing cartels
- Fraud Act 2006 simplifying offences

* PWC Biennial Global Economic Crime Survey

Who might be looking at you?



Prevention measures

- Review authorised signing levels eg cheques, purchases, expenses
- Check access to customer and other confidential data
- Look at security generally including access to premises and IT (especially out of business hours)
- Agree executive responsibilities (so things don't slip the net)
- Prepare & implement an investigation/raid action plan

...and no turning a blind eye or hoping for the best!

Raids – who, when, where, how and why?

- Who comes?
 - investigating agency and possibly police
- When do they raid?
 - first thing or when early birds arrive
- Where do they raid?
 - HQ, other offices and possibly director's homes
- How do they do it?
 - 'clean sweep' – documents, computers and/or data files; question staff; search vehicles etc
- Why me?
 - who knows at this stage! possibly an informant eg competitor, ex employee, bank or other professional

Raids - better business continuity than disaster recovery

- Compliance director responsible for raid planning:
 - coordinating response
 - instructing lawyers
 - PR management
- Nominated manager in each office
- Standing instructions for reception and other staff
- Retained law firm with appropriate expertise
- Circulation of contact details of team including cells and emails
- Label legal advice ie privileged material

Day of raid - what do you want to achieve?

- Raid is conducted legally and within investigator's authorisation
- You cooperate but do not go beyond what required by law
- You find out what its all about!
- No legally privileged documents copied or taken
- You keep copies of what is taken
- Staff who are interrogated get legal advice



Day of the raid - ten practical tips

1. Check ID of officer in charge and wording of warrant
2. Record names and/or organisation(s) of officers
3. Ask officers to wait (*in reception*) pending arrival of lawyers
4. Shadow officers during raid
5. Make written record of whole raid, times, actions, comments including any questions and answers
6. Copy or at least record documents seized and location
7. If electronic, note key words, drivers and folders searched
8. Ensure officers know what material is privileged
9. Any staff to be questioned with lawyer present
10. Plan follow up strategy including internal and external PR

Post raid plan

- Establish who is dealing with the investigation at your end
- Communication plan
- Fully brief lawyers
- Consider conflicts and independent representation for directors/staff
- Formulate response to investigation:
 - full cooperation?
 - counter investigation?
 - disclosure/leniency application?
- Consider who else is involved
- Allocate budget
- **REPUTATION MANAGEMENT**



Disclosure – Balfour Beatty example

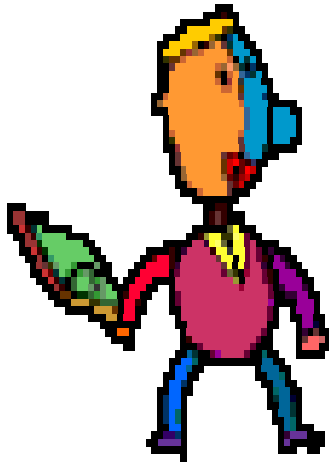
- Voluntary disclosure to SFO of possible corruption and false accounting
- SFO undertakes full investigation
- BB consents to Civil Recovery Order and pays £2.25 million
- No prosecution of anyone!
- Voluntary compliance monitoring by SFO for agreed period



Richard Alderman, SFO director says:

*“This is a highly significant development in our efforts to reform British corporate behaviour. We now have a range of enforcement tools at our disposal, and **a major factor in determining which of those tools is deployed will be the responsibility demonstrated by the company concerned.**”*

Are you going to be ...

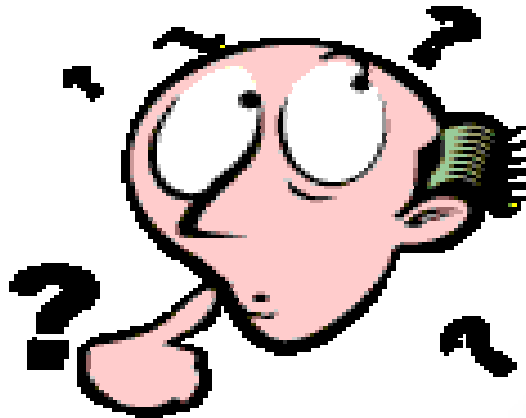


OR



Best advice ...

- Appreciate the heightened risks in a recession
- If necessary tighten up your accounting systems eg ordering labour and materials and authorising payment
- Keep a closer watch your suppliers, customers, subcontractors and your cash
- Plan for the risk of insolvencies, investigations and raids



Investigations in a recession

Peter Wilson, partner

Email peter.wilson@bllaw.co.uk

DDI: +44 (0)207 814 6850

Cell: +44 (0)7900 245 984