Section 233B Insolvency Act 1986 – What does it mean for construction contracts?

The Corporate Insolvency & Governance Act 2020 introduced a raft of measures designed to provide additional protection to companies in the wake of the Coronavirus outbreak. It applies to contracts already entered into, as well as contracts to be entered into.

One effect has been the introduction of section s233B into the Insolvency Act 1986.

Section 233B provides, in connection with contracts for the supply of goods and services, that where a company enters into a formal insolvency process such as administration, liquidation or a CVA, the ability to terminate the contract on the ground of insolvency or to take any other step is severely restricted.

The definition of insolvency event applicable to Section 233B does differ from that which we see in pre-printed construction contracts.

In most construction contracts there are express provisions detailing what happens in the event of insolvency (as defined in the contract itself) and containing provisions for the termination of the contract in such circumstances. See for example Section 8 of the JCT Standard Building Contract. Furthermore, there are statutory rights enshrined within the Construction Act 1996 whereby a contractor is entitled to suspend services in the event of non-payment. Therefore, what is the scope of Section 233B and what does all of this mean in practice.

Section 233B: Who does it work to protect?

Let us assume a theoretical construction project involving an employer, a main contractor and a sub-contractor. Section 233B places restrictions on the actions that the supplier of goods and services can take in the event of insolvency of the client. So, in the case of this theoretical example, the main contractor's remedies would be restricted in the event of insolvency of the employer and the sub-contractor's remedies would be restricted in the event of the insolvency of the main contractor.

Importantly, Section 233B does not impose any restriction on the action that an employer might take in the event of main contractor insolvency, or that the main contractor might take in the event of sub-contractor insolvency.

Section 233B: What does it restrict?

Assuming an insolvency event has arisen, Section 233B restricts the following (in the absence of consent or court permission):

- The operation of a contractual clause automatically terminating the contract upon an event of client insolvency;
- The operation of a contractual clause imposing a different regime upon an event of client insolvency;
- The operation of a contractual clause entitling the supplier to terminate because of client insolvency;
- The operation of a contractual clause entitling the supplier to impose a different regime in the event of a client insolvency; and
- The exercise of a right to terminate for any reason (so not insolvency) which has arisen before the event of insolvency but has not been exercised at the date of insolvency.
- Imposing a condition on supply after client insolvency to the effect that unpaid charges are paid.

None of this restricts the ability of an employer under a construction contract from exercising rights and remedies as against an insolvent contractor. So far as that is concerned, Section 233B does not change anything. However it does appear to severely hamper the position of the contractor.

Taking Section 8 of the JCT Standard Building Contract as an example, Section 8.10.1 provides a right for the contractor to terminate on the ground of employer insolvency and Section 8.10.3 provides that in the event of employer insolvency the obligation to continue providing services is suspended. Section 233B would prevent reliance on these contractual provisions. We return to statutory rights to suspend below when we consider unanswered questions.

As drafted, the section does not appear to restrict:

- The exercise of a general right of termination (i.e. a clause which entitles a supplier to terminate at will, even if its justification for exercising the clause might be insolvency);
- An automatic termination clause within a sub contract to the effect that if the main contract is terminated then the sub-contract is automatically at an end (as that would be engaged not because of client insolvency but because of the termination of a superior contract).

Unanswered questions

Perhaps the most obvious question over the operation of Section 233B is how it co-exists with statutory rights of suspension. It appears that a contractual right to suspend services (such as Section 8.10 of the Standard Building Contract, considered above) is overridden by Section 233B. But what about a statutory right to suspend? Under

Section 112 of the Construction Act 1996 a contractor under a construction contract (as defined in the Construction Act) has a statutory right to suspend services in the event of non-payment.

However, Section 233B(7) prohibits a contractor from doing anything that would have the effect of making the payment of debts a condition of supply and so is concerned with more than just contractual rights. Section 112 has not been repealed, so it will now be up to the Courts or the Government to provide clarification.

Clarification may also be needed in connection with the following:

- Whether a right to suspend (statutory or contractual) exercised before an event of insolvency can be maintained after the commencement of insolvency?
- Whether a right to suspend exists in the event that services are provided after the commencement of insolvency but payment is not made in respect of those services?
- Whether any retention of title clauses can be exercised by a supplier against an insolvent client?
- Whether any guarantees can be called upon?

Practical considerations

The coming into force of Section 233B could be seen as more of an issue for contractors than for employers, but employers should nevertheless consider how it might influence the terms on which a contractor is prepared to contract. There should be no reason to delete clauses such as those appearing at Section 8.10 of the Standard Building Contract as we do not know for how long Section 233B will be with us and, furthermore, while we have Section 233B there is nothing to prevent reliance on such clauses with consent or court permission.

However, will it give rise to contractors seeking a wider range of termination provisions to make up for any inability to rely on insolvency clauses? Will the price for the provision of construction services increase to reflect a shift in risk, and might we see a greater use of project bank accounts with additional provisions in place to ring fence the funds in the account from a liquidator or administrator (similar to the considerations when creating a rent deposit in a commercial landlord and tenant scenario)?

The impact and implications of Section 233B remains to be seen. What is of most significance however is that parties to existing construction contracts recognise its existence and that advice is taken by contractors before clauses that may be caught by Section 233B are activated and by employers (or any appointed insolvency practitioner) if faced with such clauses having been purportedly activated.

How we can help

For advice about the issues in this post, contract the real estate team.

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