

Protection against the insolvency of the construction company

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Just like anywhere, the nightmare of any investor in the construction area in Romania is the insolvency of the construction company.

The illiquidity of the construction company during the execution of construction works or during the warranty period draws serious effects for investors: the blockage of the construction works leads to the impossibility of completing the project in due time, financial loss threatens, the remedy of identified defects on the account of the construction company becomes difficult or even impossible, and so on.

Given the abovementioned risks, it is highly recommended for investors to protect themselves against a potential insolvency of the construction company and to minimize the financial risks.

There are various measures available for preventing/ reducing the negative effects of a potential insolvency of the construction company during the execution of construction works or during the subsequent warranty period. We shall name a few below:

1. The previous verification of the legal and financial situation of future contractual partners

Before the conclusion of a construction contract, it is highly recommended to carry out a thorough research regarding the conductor in company in the official registers (such as the Trade Register, the Insolvency bulletin, the internet page of the local courts, the Ministry of Finance, the Archive of securities on mobile goods). From the information obtained there, certain discrepancies /problems regarding the construction company (such as the initiation of an insolvency proceeding, open debts, securities, ongoing trials) can be identified. Access to some of those databases requires a subscription; law firms usually fulfill all requirements.

Should the abovementioned verification reveal a precarious financial/legal situation of the construction company, the investor should not conclude any contract, in order to avoid subsequent difficulties from the very beginning.

2. A balanced payment plan

An important measure in order to minimize risks is the creation of a balanced payment plan in the construction contract.

Investors should only pay for the services which have been actually provided (also taking into account security retentions, see below). Therefore, the construction progress and the completion of the work should be closely monitored. Otherwise, any overpayment may be lost in case of insolvency. It is highly uncertain whether the investor will receive the excess amount in or after the insolvency proceeding.

3. Security instruments for advance payments

In order to avoid financial loss, the investor should secure advance payments exclusively by means of bank guarantees which ensure the reimbursement of the advance money in case the construction company does not fulfill its contractual obligations properly.

4. Contract performance security

A bank guarantee should be agreed also for contract performance. The value of such performance bank guarantee will be made available to the investor right after signing the contract; it secures all claims of the investor arising from the contract performance, especially the ones related to the execution of the agreed services, default interests / penalties, damages, as well as the reimbursement of undue payments (payment of sums that exceed the amounts due). In case the construction company provides no contract performance guarantee, the investor should retain a corresponding amount of each invoice as a contract performance retention.

5. Warranty security

Upon the final acceptance, the developer should provide the investor with a bank guarantee which should cover all claims of the investor relating to the warranty obligation of the contractor. In case no bank guarantee is provided, the investor should be entitled to retain a corresponding percentage of the total value of the contract (plus the agreed addenda) from the final invoice for the duration of the agreed warranty period.

Conclusion

Concerning the protection against a possible insolvency of the construction company, it is highly recommended to conduct verifications regarding the legal and the financial situation of the future contractual partner before the conclusion of the construction contract. Moreover, the establishment of a balanced payment plan and the agreement of efficient security instruments in construction works are very important.

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