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The Balance-Sheet Trap: Why Specialist Subcontractors Can't Always Afford to Be Right

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> A specialist subcontractor can be entirely in the right, with a well-evidenced variations account, a watertight prolongation case, and retention wrongly withheld, and still settle for a fraction of what they are owed. Not because the merits failed, but because the accounts could not carry the fight.

This is one of the quietest structural problems in construction disputes on both sides of the Atlantic, and it has very little to do with who has the better case. It has to do with how a claim looks on a balance sheet.

The asymmetry nobody designed, but everyone lives with

Accounting standards treat a claim you are pursuing very differently from a liability you are exposed to. Under UK GAAP (FRS 102) and IFRS (IAS 37), the money you hope to recover is a **contingent asset**. You generally cannot put it on the balance sheet unless recovery is virtually certain, and a live dispute, by definition, is anything but. Even where success is probable, the standard only allows disclosure in the notes, not recognition as an asset. US GAAP takes the same conservative line: under ASC 450, gain contingencies are not recognised until they are effectively realised.

Now look at the other side of the ledger. The cost of pursuing the claim, namely solicitors, counsel, and delay and quantum experts, is real, immediate, and cash-consuming. And the downside risk often has to be provided for or disclosed long before any hearing.

So the structure is brutally one-sided. The upside of a strong claim cannot strengthen your balance sheet, while the costs and risks of pursuing it are free to weaken it. A subcontractor can be sitting on a

seven-figure entitlement and watch it do nothing for their financials, at precisely the moment they need financial strength most: working capital, bonding and surety capacity, banking covenants, and the financial checks that sit behind every prequalification questionnaire.

> THE ASYMMETRY
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Adverse costs and the Atlantic divide

This is where the UK and US diverge sharply.

In England and Wales, costs follow the event. Lose, and you generally pay a large share of the winner's assessed legal costs on top of your own. That adverse costs exposure is a contingent liability that is genuinely hard to quantify and genuinely frightening to a director, and to an auditor assessing going concern. For a modestly capitalised specialist contractor, an adverse costs order can be an extinction-level event, which is exactly why the threat of one is such an effective settlement lever for a better-funded opponent.

The United States runs on the **American Rule**: each side usually bears its own attorneys' fees regardless of outcome, absent a statute or a contract clause. That removes much of the adverse-costs terror, but it does not remove the trap. American litigation substitutes its own cost engine, namely **discovery**. The expense and duration of US-style document production and depositions can dwarf a UK adjudication many times over, and that burn rate hits a subcontractor's cash and accounts just as hard.

Different mechanisms, same outcome: the cost and risk of the dispute land on the claimant's financials, while the entitlement they are chasing sits in the notes, invisible and inert.

Why the year-end audit becomes a settlement engine

The audit is where this quietly comes to a head.

At year end, auditors require directors to assess provisions, disclose contingent liabilities, and confirm the business is a **going concern**. A live, unresolved dispute is deeply uncomfortable in all three respects. How much should be provided for adverse costs? Can the recovery be relied upon? Is the company solvent if the case goes the wrong way? None of these questions has a clean answer while the fight is ongoing.

So a predictable thing happens as the year-end approaches. A clean, unqualified set of accounts is worth a great deal. It protects covenant headroom, supports bonding lines, and keeps the company eligible for the next round of tenders. The pressure to remove uncertainty before the auditors sign off becomes intense. And the simplest way to remove uncertainty is to settle.

The better-capitalised party, usually the main contractor or the employer, understands this rhythm perfectly. They can afford to let a dispute run across a reporting date. The specialist often cannot. Settlement timing ends up dictated by the audit calendar rather than the strength of the claim, and the discount the subcontractor accepts is, in effect, the price of a tidy balance sheet.

The staying-power gap

Strip it all back and the real contest is rarely about merits. It is about who can carry the dispute on their accounts for longer.

A large contractor can absorb legal spend, provision comfortably, and wait. A specialist subcontractor, labour-heavy, retention-starved, and working on thin margins, frequently cannot. The result is a system in which the party that is right and the party that prevails are not reliably the same party. That should trouble anyone who cares about a healthy supply chain.

What actually helps

The encouraging part is that the trap is increasingly avoidable, if it is planned for early rather than discovered at year end:

- **Third-party litigation funding** lets a claimant pursue a meritorious case without the legal spend draining their own working capital, keeping the cost off their cash flow and out of the going-concern conversation.
- **After-the-event (ATE) insurance**, in the UK, can cover the adverse costs exposure. Once that risk is insured, it can often be removed from the provisioning and going-concern analysis, which is frequently what unlocks an auditor's comfort.
- **Adjudication under the UK Construction Act** remains the great equaliser: a 28-day, interim-binding, "pay now, argue later" process that is faster and far cheaper than litigation or arbitration, and that shifts cash to the subcontractor while the wider dispute continues.
- **Damages-based agreements (DBAs)** go furthest of all, and are dealt with on their own below.
- **Claims discipline**, meaning contemporaneous records, properly notified variations, and clean delay evidence, lowers the cost of proving entitlement and makes funders and insurers willing to back the case in the first place.

None of these change the accounting standards. What they change is the shape of the risk the standards force a subcontractor to carry, turning an open-ended liability and a cash drain into something insured, funded, or accelerated, so the balance sheet can survive long enough for the merits to matter.

The cleanest way out: a no-win, no-fee DBA

Of all the options, a damages-based agreement is the one that most completely dismantles the balance-sheet trap, and Systech structures it to do exactly that. A DBA is **non-recourse**: the adviser is paid an agreed percentage of whatever is actually recovered, and nothing at all if the claim fails. Systech then pairs the DBA with after-the-event (ATE) insurance, which covers the other side's costs in

the event the claim is unsuccessful. Together, the two make the arrangement genuinely **no win, no fee**. If the claim does not succeed, the subcontractor pays nothing: not its own lawyers and experts, and not the opponent. And because no fee is payable and no adverse-costs exposure crystallises unless and until the claim succeeds, there is no contingent liability to recognise and nothing to provide for. Pursuing the claim does not touch the balance sheet at all. The cost of the fight, and the risk of it, sit with Systech, not the subcontractor.

That is only possible because of how Systech is built. Running legal, claims, and delay and quantum under one roof, coordinated, senior-led and deliberately not over-lawyered, lets it control the cost of a case tightly enough to carry the risk itself. On that basis Systech offers DBAs, backed by ATE, to specialist subcontractors with strong, merit-based claims: the full firepower of a single-source MDP on a true no-win, no-fee footing. The funding obstacle that normally forces an early, undervalued settlement disappears, and with it the year-end pressure to capitulate. The subcontractor stops being the party who can least afford to be right. For a David facing a Goliath, that is what finally lets the merits, not the balance sheet and not the audit clock, decide the fight.

> A claim should be won or lost on its facts. Too often it is won or lost on a balance sheet, an audit deadline, and the asymmetry between recognising your costs and recognising your entitlement.
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> Specialist subcontractors who understand that dynamic, and who structure their funding and risk transfer before the dispute rather than during it, give themselves the one thing the accounting rules otherwise take away: the staying power to be right.

DISCUSS YOUR CLAIM

Are you weighing a strong claim against the cost of pursuing it? Speak to us candidly about the prospects of pursuing your claim.

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