

## Construction Law

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# Reforms to statutory payment provisions

Major changes to the Construction Act 1996 are currently due to come into force in October 2011.

Significant changes will affect the payment provisions contained in Sections 110 - 112 of the Construction Act, which are the focus of this article. There will also be changes to adjudication provisions. A key change is that in order to be a qualifying construction contract, that contract no longer has to be in writing. This could well have ramifications for the application of the new payment provisions.

### 1. 'Paid when certified' provisions will essentially be ineffective.

The provision remains under s.110 that a construction contract shall provide an adequate mechanism for determining what payments become due and when and must provide a final date for payment. Currently 'pay when paid' clauses are ineffective except where caused by an insolvency up the line. That much remains the same, but now 'pay when certified' provisions will become ineffective (unlike the current position). There will be certain exceptions to this, for example for management contracting. Further, any attempt to make the due date for payment dependent upon when the payer gives a payment notice will be ineffective.

### 2. Provisions for payment notices have been expanded.

One of the main changes to the provisions for payment notices is that in addition to a requirement that the payer gives notice not later than five days after the due date (which must state the sum the payer considers due and the basis on which that sum is calculated), in default the payee may now give such a notice.

If, as with most standard form contracts, the contract provides that the payee may make an application for payment, that application shall stand as the payment notice if the payer fails to issue one. That application by the payee will be regarded as compliant with the provisions of the Act.

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### From the Editor

Welcome to the June 2011 edition of Construction Law, Thomson Snell & Passmore's newsletter highlighting some key issues relating to those involved in the construction industry.

If you would like further advice on any of the issues covered please contact Chris Kirby-Turner.

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This could be significant for the payee in circumstances where the sums being applied for are running ahead of the sums to be certified. However, clearly the payer can recover the situation if they serve a valid pay less notice in time, or if they deal with the situation in a subsequent interim payment (if there is one).

### 3. The ‘withholding notice’ will become ‘pay less notice’.

The withholding notice is to be abolished and replaced with a pay less notice, still under s.111. This section is now called ‘Requirement to pay notified sum’. It requires the payer to pay the notified sum on or before the final date for payment. It now enables the payer to give a notice of their intention to pay less than the notified sum. The notice must specify the sum that the payer considers to be due on the date the notice is served and the basis on which that sum is calculated.

There is no longer a requirement that if less is to be paid, the notice must state what the grounds are for the reduced payment, and if there is more than one ground, each ground and what element of the reduction applies to each ground. There is therefore currently some concern as to what “basis on which that sum is calculated” will mean, and whether this will lead to much less detail being required in order for a such a notice to be effective (for example, if only stating the net sum due, and not the supporting calculation).

Whether this will have any adverse impact on the payee in practice remains to be seen. Arguably there is no difference in effect regarding payment notices, as the current provision requires the notice to state the “basis upon which the amount was calculated” (to be changed to “basis on

which that sum is calculated”). In terms of pay less notices, it will be whether “basis” will equate to “ground” and the current further requirements where there is more than one ground.

### 4. The right to suspend for non-payment has been enhanced.

The right of a payee to suspend in default of full payment by the final date remains, and seven days’ notice must still be given. However, the changes mean that the payee may suspend “any or all of his obligations” - previously the payee could only suspend all of the obligations. This could provide a powerful tool for contractors who will be able tactically to pick and choose what work is suspended.

Further the Act will provide that the party in default is liable to pay a reasonable amount in respect of costs and expenses reasonably incurred as a result of the payee exercising this right. This may also include the costs of de-mobilisation and return to site. In addition, the Act will now widen the current entitlement to an extension of time to cover any time spent as a consequence of exercising the right of suspension, namely the actual period of suspension. This should therefore include the time spent re-mobilising.

### Summary

In summary it will be interesting to see what difference these changes make. There are some enhanced rights, which will be useful to contractors. However in terms of the payment and pay less notices, the wording of the Act will be much more verbose and complicated, and one is left wondering ‘If it ain’t broke...’ ■

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### Commentary

The proposed changes to the Construction Act have wide-ranging implications to two fundamental aspects of any project: getting paid, and resolving disputes.

The reforms have taken several years to progress through numerous lengthy consultation processes, and so are in no small part a product of the pre-recession industry. Making some significant changes to well established procedures will undoubtedly cause a higher administrative burden whilst parties familiarise themselves with the new payment regime, inevitably increasing the risk of disputes.

Amongst the industry, reaction to the reforms is far from universally upbeat. However, once grappled with, the reforms do provide an opportunity to give welcome clarification to the last 15 years or so of case law and to more fully address the many ‘what ifs’ surrounding the default payment provisions.

## ...and that's not all

Quite apart from the industry familiarising itself with the new default payment provisions (which could well increase the risk of an avoidable dispute if not followed correctly), the adjudication procedures are also subject to more subtle, but nonetheless significant, reform.

“The practical concerns remain as to whether this will dilute the value of adjudication as a fast (some would say quick and dirty) dispute resolution process.”

“For adjudication to be a time and cost effective process, the courts will not get embroiled in assessing whether the decision is right or wrong - the epitome of its rough and ready nature.”

The three main changes that will apply to the statutory adjudication provisions are as follows:

### 1. A contract no longer needs to be in writing

Currently, only a construction contract that is in writing (either wholly or substantially) is subject to the statutory adjudication provisions. The logic behind this has always been that in the very short timescales involved in adjudication, it is simply impracticable for the adjudicator to first have to establish what the terms of the contract actually are (where there is little, if anything, in writing).

Whilst this will significantly increase the number of disputes that can potentially be resolved by adjudication, the practical concerns remain as to whether this will dilute the value of adjudication as a fast (some would say quick and dirty) dispute resolution process.

A side effect may also be to increase the number of cases where a ‘no contract’ argument is run. Here, the dispute must be resolved on the basis of an assessment of a fair value for the work (if there was truly no agreement reached on the cost of the work, or the basis on which it was to be assessed). Whilst a no contract argument is potentially a useful get out for a party on the receiving end of an adjudication, such disputes are notoriously difficult to resolve (given the magnitude of the task for an expert to assess the value of the works). An increase in the frequency of this argument being run may well prove unwelcome.

### 2. The adjudicator can still get it ‘wrong’

Generally, provided there is no procedural irregularity, where an adjudicator gets their decision ‘wrong’ it will still be enforceable (as either party will always have the option to commence court proceedings to have matters dealt with on a final basis). The reason for this is that for adjudication to be a time and cost effective process, the courts will not get embroiled in assessing whether the decision

is right or wrong - the epitome of its rough and ready nature.

Over the years, limited exceptions have been developed by the court, including the ‘slip rule’, which allows an adjudicator to correct any obvious error in their Award (most commonly, an arithmetical error).

Parties have naturally sought, almost invariably without success, to extend this principle to correct other mistakes. That avenue now looks to be closed by placing the slip rule on a statutory footing, and therefore underlines the ‘pay now, argue later’ approach applied by the court when adjudication Awards are enforced.

### 3. Agreements on payment of costs

Case law has previously outlawed clauses whereby the costs of a dispute are allocated between the parties at the time of the contract, irrespective of the eventual result (so-called Tolent clauses). As part of the amendments to the Construction Act, it was intended to put this on a statutory footing to confirm that such agreements are ineffective; instead, only agreements entered into after the dispute has arisen would be effective.

Whilst this is what was intended under the Act, unfortunately there is serious ambiguity in the proposed wording. This has attracted widespread criticism from the industry (and a judge in a recent Scottish case), as it potentially allows such arrangements to be permitted by the back door. Therefore, it would be dangerous to sign up to a contract containing such a clause on the assumption that it would be ineffective by virtue of case law, unless or until the ambiguity in the new act is resolved.

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Given current market conditions, exemplified by high profile casualties such as Rok and Connaught, whether companies have sufficient assets to take on large projects is a valid concern.

## Protect against the risks from unsure finances

This applies to employers/developers as well as contractors - employers need their chosen contractor to be able to complete their works; contractors (and sub-contractors) want assurance they will be paid.

Availability of sufficient assets can be more problematic for smaller developers and contractors - despite being "open for business" (as they are constantly telling us), in many cases banks are proving reluctant to lend.

Where the financial position is less certain, what security is available? For employers, the usual suspects:

- performance bonds, typically for 10% of the contract
- parent company guarantees
- collateral warranties or third party rights.

For contractors (of any tier) security of payment is the biggest concern. They could consider protecting against employer insolvency or default by requesting:

- an escrow account - the employer pays into a joint account (in the names of the employer and the contractor/ the contractor's lawyers) either regular payments, or a lump sum to be paid out if the employer defaults

- alternatively a project bank account which then allows direct payments to be made by a bank to the contractor, sub-contractors and suppliers
- advance payments if plant or materials need to be paid for up front (for which an on-demand advance payment guarantee will likely be required by the employer in return)
- payment without deduction of retention (an on-demand retention bond will be required in exchange)
- a parent company guarantee from the employer
- front-loaded stage payments.

In the current buyers' market the extent to which an employer may agree to provide these is debatable, but as the saying goes 'If you don't ask, you don't get'.



This article (below and above) is based on an article by Chris Whittington, Head of Construction & Engineering, published in Construction News on 12 May 2011.  
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## Funding

Clearly funding is available in the private sector - British Land recently announced £3bn of available funds on top of £1.5bn already committed. Its £290m 'Cheesegrater' tower in the City is moving forward. Land Securities announced a joint venture with Canary Wharf last October for the 37 storey 'Walkie Talkie' building at 20 Fenchurch Street. The Shard, unfinished but already Britain's tallest building, continues apace.

The major contractors appear to have the necessary financial strength to take on major projects, whether alone or in joint venture (e.g. Morgan/Vinci/Bachy on the Lee Tunnel for Thames Water).



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