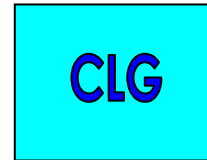


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Guidance on the Construction Act changes and what they mean for Main Contractors

Amendments to the Construction Act 1996 will come into force on 1 October 2011 (1 November 2011 in Scotland) by virtue of Part 8 of the Local Democracy, Economic Development & Construction Act 2009. Regulations amending the existing Scheme for Construction Contracts (the “Scheme”) are currently being reviewed by government but are also expected to come into force at the same time.

The purpose of this guidance is to set out in general terms what the changes are and in particular how they will affect Main Contractors.

The amendments include changes which:

1. remove the requirement for a construction contract to be in writing;
2. make changes to the adjudication procedures;
3. change fairly substantially the payment terms to be incorporated in construction contracts;
4. clarify that legitimate suspending parties are entitled to recover reasonable costs and expenses of the suspension:.
5. make a number of changes to the default Scheme for Construction Contracts; and
6. will require careful management in respect of any sub-contracts (to include novated consultancy agreements) entered into after 1 October 2011, particularly where the main contract was entered into prior to that date.

1. Removal of the Requirement for a Construction Contract to be in Writing

Construction contracts need no longer be in writing. The terms of Section 107 of the Construction Act has been repealed. However by virtue of changes to Section 108 of the existing Construction Act for parties to be able to refer disputes to adjudication, the construction contract must incorporate “provision in writing”, enabling the parties to refer any dispute to adjudication.

Notwithstanding these amendments, contractors are advised to continue to record all construction contracts fully in writing. It is anticipated that the use of entire agreement and non waiver clauses will become more common, particularly with a view to excluding verbal agreements.

Where oral contracts are referred to adjudication, the adjudicator will have to decide if an oral contract has been entered into and what the terms of that contract are. That in itself will lead to an increase in adjudication hearings and witness examination, which will have to be facilitated within the already tight adjudication timetable.

2. Changes to the Adjudication Procedure

Following the amendments, the following changes have been introduced to the adjudication procedure:

- 2.1 Section 108(3A) now requires a contract to include a written slip rule “*permitting the adjudicator to correct clerical or typographical errors by accident or omission*”. The amendments to the Act do not however set a time within which an adjudicator must correct any decision or reissue it.

Accordingly when amending contracts to incorporate a written slip rule provision, contractors are recommended to incorporate a time limit within which the adjudicator’s decision should be corrected or reissued. In doing so, consideration needs to be given to the existing time limit within which the adjudicator’s decision need be made so as to avoid any arguments on whether any decision can be enforced if its corrected version is given outside the adjudication time limit.

Under the amended Scheme for Construction Contract, an adjudicator can correct his decision to remove a clerical or typographical error arising by accident or omission “*on his own initiative or on the application of a party*”. Further paragraph 22A(2) requires any correction to be made “*within five days of the delivery of the decision to the party*” and that the amended decision be effected “*as soon as possible*” thereafter. The effect of paragraph 22A makes clear that any amendment to the decision forms part of the decision thereby effectively backdating the amendment such that it falls within the timescale required for the adjudication.

2.2 Costs of Adjudication Proceedings

Interestingly Section 108A of the amended Construction Act was supposed to prohibit agreements as to adjudication costs such as those seen in *Bridgeway Construction v Tolent Construction Ltd* (2000) CILL 1662. In that case a term was included in a sub-contract which provided that all adjudication costs and expenses would be borne by the party who refers a dispute to adjudication.

However, notwithstanding the clear intention of government to ban Tolent type provisions, the actual wording contained within the amendments could arguably have the opposite effect. Main Contractors may wish to consider the actual wording within the amendments with their solicitors as potentially they may bring an unintended benefit.

The new wording states:

Section 108A:

“(1) This section applies in relation to any contractual provision made between the parties to a construction contract which concerns the allocation as between those parties of costs relating to the adjudication of a dispute arising under the construction contract.

(2) The contractual provision referred to in subsection (1) is ineffective unless-

(a) it is made in writing, is contained in the construction contract and confers power on the adjudicator to allocate his fees and expenses as between the parties, or

(b) it is made in writing after the giving of notice of intention to refer the dispute to adjudication.”

3. **Change fairly substantially the payment terms to be incorporated in construction contracts.**

- 3.1 The old payment notices (s.110(2)) and the withholding notices (s.111)) have been dispensed with. They have been replaced with an entirely new regime of payment notices that must be contained in any “*construction contract*”, the definition of which has not been altered (see s.104). If no such regime is included in a construction contract or the contract incorporates a non-compliant regime, the Scheme will apply (see below).
- 3.2 The ‘old’ Construction Act obliged the parties to provide for an adequate mechanism for determining what payments become due and when. That has not changed. A key difference is that, if a valid payment notice is now issued, the amount stated in the payment notice will determine the amount that must be paid. The payer must pay the amount specified in such payment notice unless he issues a further valid notice specifying what the payer considers should be paid.
- 3.3 The contract must provide that either the payer or the payee must issue a payment notice specifying the amount considered to be due and the basis upon which that amount has been calculated. Also, what is referred to as a “*specified person*” (typically an architect, engineer or employer’s representative under a main contract) may, instead of the payer, issue this notice. In this guidance, these notices are respectively referred to as a payer notice and a payee notice and collectively as payment notices.
- 3.4 The concept of a “*due date*” and a “*final date for payment*” has been retained and the parties remain free to agree in the contract when the due date arises. Absent such agreement, the Scheme will dictate these dates. These payment notices must then be given no later than 5 days after the due date.
- 3.5 For simplicity, this note will describe how these notices can operate in a sub-contract, where the payer is the main contractor and the payee is the sub-contractor. However, the same principles will apply in a main contract, albeit that the specified person may issue the payment notice in lieu of the employer.
- 3.6 The notice provisions may be led by the main contractor being obliged to issue the payment notice (by independent valuations) or the sub-contractor being obliged to issue the payment notice (application led).
- 3.7 If the sub-contract obliges the main contractor to issue the payment notice:
 - if a valid notice is issued, this will determine the amount that the main contractor must pay;
 - the main contractor may, however, issue a further notice (referred to in this guidance as a pay less notice) revising this amount: the concept of a withholding notice has been dispensed with and so a fresh ‘valuation’ must be included in a pay less notice.

To be valid these notices must show the basis upon which the amount stated as due has been calculated. There is no guidance as to how much detail must be provided. No doubt, the Courts will generate precedent in this regard. To be valid, a payment notice must be given no later than 5 days after the due date. A pay less notice must be given no later than the “*specified period*”

before the final date for payment. The parties remain free to agree in the contract the specified period. Absent such agreement, the Scheme will dictate a period of 7 days.

A payment notice that does not comply with these requirements will be of no effect.

- 3.8 If the sub-contract obliges the main contractor to issue the payment notice but no such notice (or an invalid notice) is issued, then the sub-contractor may - after the last date upon which the payment notice should have been issued - issue its own notice (referred to in this guidance as a default notice) specifying the amount considered to be due and the basis upon which that amount has been calculated. **Unless the main contractor responds to a default notice before the specified period before the final date for payment, the main contractor must pay the amount specified in the default notice.** The final date for payment is extended by an additional period in order to give the main contractor an opportunity to do this by serving a pay less notice. This additional period is equal to the period of delay of the sub-contractor issuing its default notice.

Again, there is no guidance as to how much detail must be provided. If a pay less notice is issued, it is suggested that the pay less notice should provide at least the equivalent level of detail to that provided in the sub-contractor's default notice.

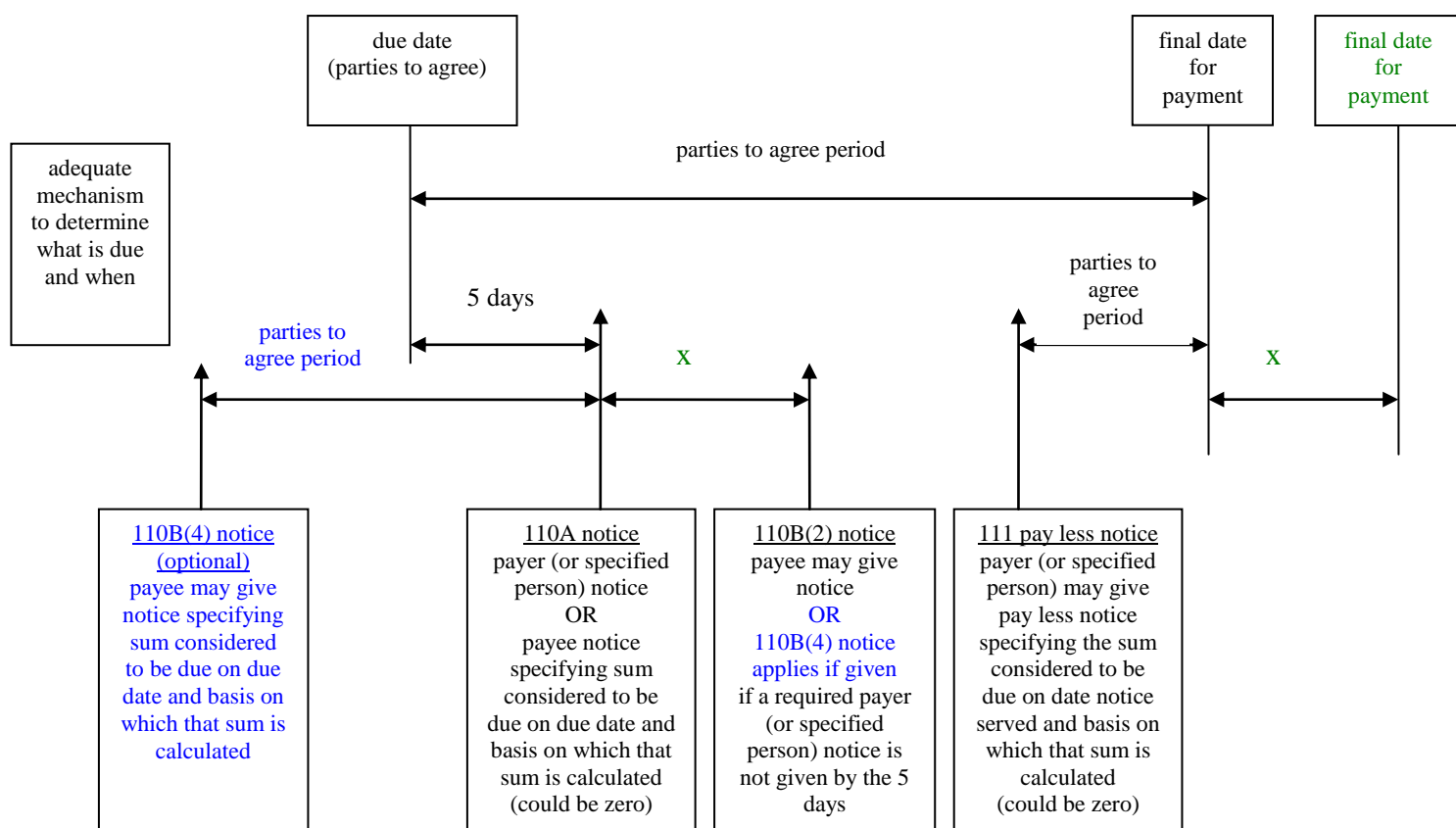
- 3.9 If the sub-contract obliges the sub-contractor to issue the payment notices (typically an application):
- if a valid notice is issued, this will determine the amount that the main contractor must pay;
 - the main contractor may, however, issue a pay less notice revising this amount: the concept of a withholding notice has been dispensed with and so a fresh 'valuation' must be included in a pay less notice.

Again, a pay less notice must be given no later than the "*specified period*" before the final date for payment (see paragraph 3.6 above). Again, it is suggested that the pay less notice should provide at least the equivalent level of detail to that provided in the application.

Importantly, again, unless the main contractor responds to an application that constitutes a payment notice before the specified period before the final date for payment, this will determine that the main contractor must pay the amount specified in the application.

- 3.10 The new amendments also seek to ban payment provisions which rely on third party obligations and decisions (e.g. prohibiting pay when certified and pay what certified clauses) except for management style contracts. This means that release of retention in a sub-contract cannot be linked to practical completion and the issue of a certificate of making good in the Main Contract. Accordingly contract amendments will be needed to many sub-contracts to remove such conditionality.
- 3.11 However, government have issued an Exclusion Order which includes a power for yet to be specified construction contracts (likely PFI or PPP contracts) to be excluded in part from the Acts provisions. Therefore the ban on payment provisions which rely on third party obligations or decisions will not apply to first tier sub-contractors in a PFI or PPP arrangement. The Exclusion Order does not however remove the restriction on pay when paid provisions to first tier PFI and PPP sub-contracts.

CONSTRUCTION ACT PAYMENT PROVISIONS FLOW CHART



4. Suspension - clarify that legitimate suspending parties are entitled to recover reasonable costs and expenses of the suspension.

The new amendments now clarify that where a party legitimately suspend performance of their obligations under the contract, they are now entitled to recover their reasonable costs and expenses of the suspension. It also makes clear that a contractor (or sub-contractor) can suspend work relating to a particular part of their works only and therefore no longer have to suspend all their work.

Obviously this can have advantages for Main Contractors should they need to suspend their obligations under the Main Contract.

However, on sub-contracts, previously as the Construction Act was silent on these issues, Main Contractors were sometimes able to resist such claims. However, now the position has been addressed, Main Contractors should be aware of this change and limit their exposure in that regard.

5. Changes to the default “Scheme for Construction Contracts”.

As stated above, the existing Scheme for Construction Contracts (the “Scheme”) is currently being reviewed by government and are also expected to come into force at the same time as the amendments to the Construction Act. The amended Scheme will make the following amendments:

- i. Clarify that the periods in an adjudication are to be calculated from the date the referral notice is received (paragraph 7.3).

- ii. Remove the adjudicators existing power to order that his decision be complied with peremptorily. (Note: this is unlikely to be of any significance).
- iii. If the parties have a specific provision conferring power on the adjudicator to allocate this fees and expense, the amended Scheme will provide that the adjudicator can determine how the payment is to be apportioned and that the parties will be jointly and severally liable.

6. Timing - Careful management in respect of any sub-contracts (to include novated consultancy agreements) entered into after 1 October 2011, particularly where the main contract was entered into prior to that date.

- 6.1 The amendments apply to all construction contracts (as defined by the Act) entered into after 1 October 2011 (1 November 2011 in Scotland).

Accordingly, any sub-contracts entered into after the 1 October 2011 will likely be entered into under different terms by virtue of the amendments to those entered into under the main contract prior to 1 October 2011. Main Contractors will need to be careful to manage that situation carefully so as not to find themselves in breach of the new requirements under the changes to the Construction Act.

- 6.2 Clearly there are a number of areas within the new changes which will need further clarification and provide fertile ground for disputes. Whilst the lack of clarity in light of the somewhat poor drafting of the Act is unhelpful, the required clarity is only now likely to come from the resolution of such disputes through the courts. In that regard, Main Contractors should be careful to consider their position and take the appropriate advice in relation to any areas of the new law on which they are unclear.

September 2011.