The Construction Contracts Bill will overhaul the Construction Act's payment regime and require amendments to standard form contracts, but is it change for the better?

The Construction Contracts Bill: what will change?

In July 2008, after much consultation, the government published the Construction Contracts Bill that will amend the Construction Act. While it should be enacted by Autumn 2009 and will only apply to construction contracts entered into after the Bill comes into force, it is worthwhile becoming familiar now with the planned changes.

The Act has been a qualified success for its main intended beneficiaries, namely "payees" as the Act calls contractors, sub-contractors and those further down the contractual chain. The Act's "payers" are not just developers but also contractors when dealing with sub-contractors, sub-contractors when handling sub-sub-contractors and so on.

The introduction of a statutory right to a 28-day adjudication process has broadly speaking achieved the Act's aim of speeding up the resolution of construction disputes. Over the first ten years of the Act about 15,000 adjudications took place with only around 5% of adjudicators' decisions requiring enforcement by the courts. About 1% of decisions have not been enforced invariably because the adjudicator lacked jurisdiction, appeared to be biased or failed to give a party a reasonable opportunity of being heard.

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There is, though, little evidence as to whether the Act has achieved its aim of improving cash flow in the industry.

Payment regime changes

The Bill's new payment regime will require most standard form contracts to be amended. The following table summarises the three ways in which payments will be possible under construction contracts for which it is agreed or estimated that the works will take 45 days or longer. Short contracts therefore continue to fall outside the legislation's ambit although parties may still agree to adopt its strictures.

Payment notices (PNs) lie at the new regime's heart. The PN is a document that states the sum considered to be (or to have been) due and the basis on which that sum is calculated. A withholding notice (WN) should provide the same information.

No.	Trigger for each payment	WN	Sum to be paid
1.	Payer or third party issued PN as per the contract: The payee or specified third party (say an architect) gives a PN (e.g. a certificate) specifying the sum the payer considers to be due and the basis for that sum not later than 5 days after the payment due date.	The payer or specified third party may give a WN – not later than the agreed period before the final date for payment (or if a period is not expressly agreed, not later than 7 days before the final date for payment). The WN may be appropriate where, say, a defect is found after the PN was given.	The payee should expect to receive the sum specified in the PN or, if there was one, the WN, by the final date for payment. If the payer does not pay the sum stated in the PN or the WN the payee would be entitled to that sum (and the payer would have no defence to any claim) and/or might suspend all or part of its performance. If the payee suspends it would be entitled to its reasonable costs of suspending and remobilising and an extension of time for the remobilisation period (rather than just the suspension period as now). If the payer does pay the sum stated in the PN (or the WN) the payee might adjudicate for any extra sum it considers due.
2.	Payee issued PN - the payer or third party having failed to issue as per the contract: If the PN is not given by the payer or specified third party as per the contract, the payee may at any time prior to the final date for payment give a PN. This should already have happened where a payment application preceded the expected PN, as the contract permits or requires. If the payee gives a PN the final date for payment is postponed by the same number of days after the payment due date that the notice was given.	As above	As above.
3.	Payee issued PN as per the contract: The payee gives a PN specifying the sum it considers to be due not later than 5 days after the payment due date.	As above	As above
	Example (of row 2): Interim certificates are due by the 10th of every month; the 10th is also specified as the payment due date; the payee may not later than 7 days beforehand submit a payment application; the final date for payment is the 24th of every month. The interim certificate is not given as required; the payee did not give an application by the 3rd (which would otherwise have stood as a PN) but on the 11th gives a PN stating the sum due as £100 and the basis for that sum. The final date for payment is thereby postponed to the 25th.	The payer gives a valid WN stating the sum due as £80 and the basis for that sum.	The payee should expect to receive £80 by the final date for payment. If the payee is paid nothing, the payer would have no defence to a claim for £80. Alternatively the payee might suspend all or part of its performance. If the payee receives the £80 it might still adjudicate for the extra £20 it considers due.

Insofar as a contract does not comply with the above, the statutory Scheme will apply. It appears that the Scheme will be amended (although details have yet to be provided).

There are risks for payers in the new regime (as well as certifiers and those responsible for giving notices) which should be apparent if we adjust our example as follows:

- The payee, as would usually occur, gave a valid payment application as the contract permitted (as the JCT SBC 2005 does). If the payer or certifier does not give a subsequent valid PN or WN the amount applied for is due. Where the contract (in the style of many design and build forms) provides for the payee to give the PN the payer need only fail to give one document - a valid WN – and the amount applied for is due (see row 3 of the table). The payer would have no defence should the payee pursue a claim for the sum it applied for (although the payer might seek to recover any overpayment through the next interim payment – assuming there is one). This smacks of reintroducing the JCT D&B 1998 form payment regime which the JCT rejected in its 2005 suite.

- The payer gave a WN saying "£100 – £20 for defects = £80". It is not obvious whether this would qualify as "the basis upon which the sum is calculated" or whether the defects must be specified and a value put against each.

- The payer validly terminates its contract with the payee before the final date for payment. The Bill, as drafted, would require the payer to pay the payee the £100 (or if it gave a valid WN, the £80). This would override terms in contracts (such as the JCT SFBC 1998 and JCT SBC 2005) that relieve the payer of paying a sum when its final date for payment falls after the termination. This is quite an inroad into the common law rules on termination.

  The only exception the Bill allows is that contracts may provide that where the payee goes insolvent after the WN deadline, the payer need not pay any sum due. Where a payee goes insolvent shortly before the WN is due this is hard luck on the payer who does not find out until it is too late. Any clause going beyond this dispensation would be rendered ineffective. Therefore this would strike down contractual provisions (such as clause 8.5.3.1 of the JCT SBC 2005) which say that upon the payee's insolvency no further payments fall due.

  That said the Bill would probably not remove a payer's statutory right to withhold where its payee enters liquidation (as opposed to other forms of insolvency), including in respect of sums due for which the final date for payment passed before the payee entered liquidation. That is even if the contract does not expressly allow it and the payer gave no WN for, say, in our example, its expected extra costs of completing the works and resolving the £20 of defects.

"There are risks for payers in the new regime..."

Contracts in writing

The Bill's second much heralded aim is to extend the Act's scope to include oral and partly oral contracts. This will ensure that the legislation covers contracts arising from letters of intent (which are often amended orally or by conduct but do not provide expressly for the Act's payment and adjudication regimes).

Act avoidance

The Bill seeks to ban the following devices designed to avoid the letter and spirit of the Construction Act:

- Clauses that make PNs final and conclusive (although the Bill's wording needs improving for this prohibition to succeed).

- Provisions making payment conditional on the performance of obligations under another contract or a decision by any person as to whether obligations under another contract have been performed. This would include pay-when-certified and

pay-what-certified clauses which are popular with contractors who want to defer paying sub-contractors until their client has put them in funds. However, there are unfortunate side effects for PFI/PPP transactions and management contracting for which the Bill makes no allowance.

- Clauses allocating the parties' costs before any adjudication commences.

On the other hand the Bill does not address the following potentially effective Act-avoidance devices:

- Allowing payers to withhold in respect of claims due under other contracts.
- Providing for the payment due date to be when the payer or the certifier gives the PN (and linking the final date for payment to it). This would avoid the PN being late and prevent the payee from giving its PN (as in row 2 of the table). The Bill does not suggest that this would be an inadequate payment mechanism and thereby invalid.
- Providing for any sum awarded by an adjudicator to be paid into a third party (trustee stakeholder) account and only released if and when certain conditions are met.
- Requiring the party awarded a sum by an adjudicator, or its parent company, to lend an equivalent sum back to the payer, which is only repayable as and when specified.
- Requiring any adjudicator's decision to be enforced by arbitration.

The last three of these might be avoided by the introduction of a single set of procedural rules for all adjudications but no legislation is planned in this regard.

"The government's cost-benefit analysis of the Bill's expected impact...does not withstand scrutiny."

Post-Autumn 2009

One test of the Act and the new Bill is to ask: would it have made any difference to the suppliers of those housebuilders who were reportedly asked on existing contracts to apply up to 15% price discounts, write-off unpaid retentions or extend payment periods? The Act and new Bill says nothing to protect those suppliers who agreed. It says little more for those who disagreed - save in providing a right to adjudicate. There are limits to the state's powers.

The government's cost-benefit analysis of the Bill's expected impact, while in principle an admirable exercise, does not withstand scrutiny. Many will query the true cost to the industry of changing standard forms and established payment practices as well as the associated extra training and advice that will be needed. They may also ask whether the costs for everyone of state intervention to prevent only some of the malpractices of the few are worth it.

The government suggests reviewing the proposed changes about three years after they are enacted. So, there might be only a short respite after the new Act comes into force before we are again talking about amending it. For now, though, we are closer to a new Construction Act - whatever its merits.

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CMS has been involved at every stage of the consultation process.