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The UK's Construction Act Gets Its First Face-Lift

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The Housing Grants, Construction and Regeneration Act (the "Act") was enacted in 1996 and came into force in May 1998. The Act was a long awaited attempt to address some of the fundamental problems facing the construction industry, particularly non-payment.

More than ten years later and after more than five years of consultation, the Local Democracy, Economic Development and Construction Act 2009 ("LDEDCA") received Royal Assent on 12 November 2009. Part 8 of LDEDCA will amend the adjudication and payment provisions in Part II of the Act (the "amended Act") when it comes into force on 1 October 2011 in England and Wales and on 1 November 2011 in Scotland. Similar changes will be made in Northern Ireland through the Construction Contracts (Amendment) Act (Northern Ireland) 2011, but no firm date has yet been set for when this act will come into force.

This client alert is intended to provide a brief overview of the key changes.

Will the changes affect you?

All "construction contracts" in England and Wales (as defined in the Act) entered into on or after 1 October 2011 will have to comply with the new regime. The changes are not retrospective. If the contract is entered into before 1 October 2011 then the Act will apply. The definition of "construction contract" has not been modified by the amended Act, so, all contracts that fall under exclusions in the Act or the Construction Contracts Exclusion Order 1998 will not be affected. The relevant date in relation to Scotland is 1 November 2011.

What are the key changes?

ADJUDICATION

Removal of the requirement for "construction contracts" to be in writing

This is perhaps the most significant change as it means that the amended Act, including the right to adjudicate at any time, will apply to all "construction contracts" whether wholly in writing, partly in writing, or wholly oral. This is likely to result in many more construction contracts falling within the ambit of the Act and, therefore, benefiting from its provisions. As the Act was aimed at improving cash flow in the industry, particularly down to sub-contractors, it may be said that this amendment furthers that aim as it is often the sub-contracts which are poorly documented and supplemented by oral terms. This tends to get worse the further down the contractual chain you go. However, this amendment is likely to increase disputes between parties as to what they may or may not have agreed orally.

Still a requirement for adjudication provisions to be "in writing"

Adjudication provisions within the construction contract must still be "in writing" to have effect. Accordingly, the contract provisions must comply with the requirements of the amended Act or, if they do not, the relevant provisions in the Scheme for Construction Contracts (see below) will apply instead. All construction contracts must contain the following provisions or they will be imported by the amended Act:

- a party must be able to give notice at any time of its intention to refer a dispute to adjudication;

- the contract must provide for the adjudicator to be appointed, and the dispute referred to him, within seven days of the notice to refer;
- a decision must be given by the adjudicator within 28 days of the referral, unless the parties agree to extend the period after the dispute has been referred;
- the adjudicator must act impartially in determining the dispute;
- the adjudicator's decision will bind the parties, unless/until the dispute is finally determined by agreement, arbitration or legal proceedings; and
- the adjudicator must have the ability to correct any clerical or typographical error in his decision.

Introduction of a statutory slip rule

The Act does not contain an express provision for the adjudicator to correct accidental errors or slips in his decision. However, cases such as *Bloor Construction v Bowmer & Kirkland, Nuttal v Sevenoaks, O'Donnell v Buildability* have demonstrated that, depending on the facts, an adjudicator may have an implied power to amend accidental slips. Under the amended Act, the adjudicator will have a new statutory ability to correct clerical or typographical errors in his decision.

Prohibition on agreeing who will pay the costs of the adjudication prior to the notice of adjudication

The Act does not provide who should pay the costs of the adjudication. The intention was that each party should bear its own costs. However, at the moment, parties may either expressly state in their contract or agree at any time who is to be responsible for the costs and expenses of the adjudication. The amended Act effectively bans "Tolent" clauses, that is, clauses in the construction contract which make the referring party liable for the costs and expenses of the adjudication irrespective of the outcome. However, the parties will be able to agree in the construction contract to confer power on the adjudicator to allocate his fees and expenses between the parties, but not the parties' costs.

Some commentators have suggested that the new provisions inadvertently permit the parties to make provisions for allocation of their legal and other costs so long as they also make provision for the adjudicator to allocate his own fees and expenses as between the parties. However, to rely on such a provision would be inadvisable and such a provision is unlikely to be enforceable. In any event, the parties will be free to agree liability for their costs after the notice of intention to refer the dispute to adjudication has been given.

SUSPENSION

The amended Act introduces new rights for contractors who suspend performance for non-payment. The Act allowed the contractor to suspend the performance of its obligations where it was not paid. This was an all or nothing right, a contractor could not suspend only part of its work or obligations. The amended Act allows the contractor to suspend any or all of his obligations where payment is not made by the final date for payment. This allows contractors partially to suspend where it is more commercially sensible without having to down tools completely in order to take advantage of the provisions of the Act. The amended Act also provides that the suspending party will be entitled to an extension of time to cover the valid period of suspension plus any delay suffered as a consequence and that the party in default shall be liable to pay the suspending party a reasonable amount in respect of costs and expenses reasonably incurred by that party as a result of the exercise of the right to suspend.

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PAYMENT

"Pay when certified" provisions unenforceable

Under the Act, "pay when paid" clauses that make payment under a contract contingent on the payer receiving payment from another person are not enforceable unless that person is insolvent.

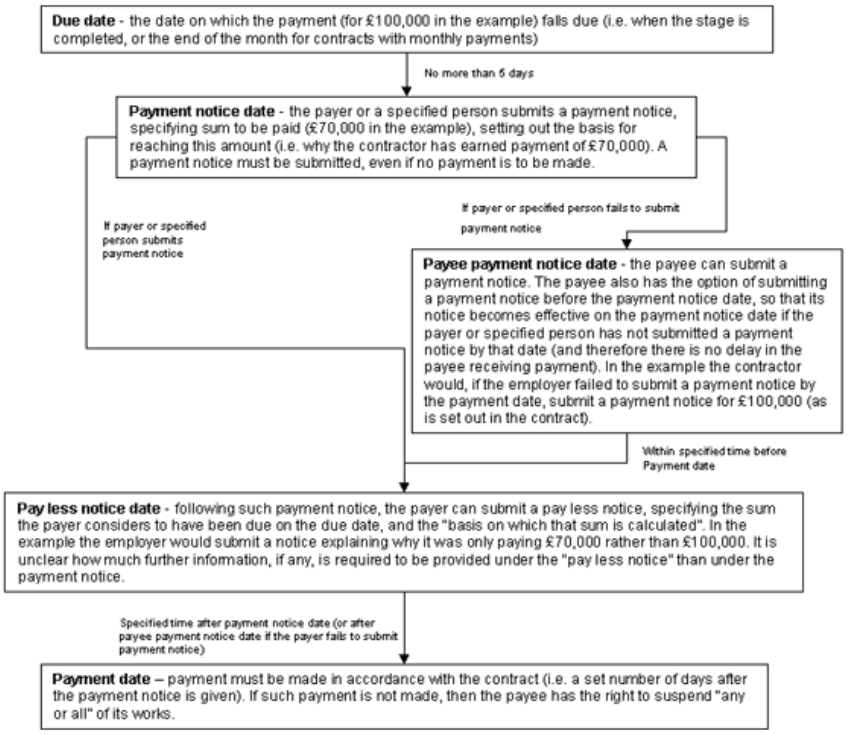
Now, under the amended Act, save for management contracts and PFI/PPP subcontracts, provisions which make payment conditional upon performance of obligations under another contract or a decision by another as to whether such obligations have been performed (that is, "pay when certified" provisions) do not satisfy the fundamental requirement that there must be an "adequate mechanism" for determining what payments are due and when. In the absence of such a mechanism, the relevant provisions of the Scheme for Construction Contracts (the "Scheme") will apply.

Pay less notice

The withholding notice has gone, to be replaced with a new "pay less" notice. This must set out the amount the payer considers to be due rather than the amount being withheld and the "basis on which that sum is calculated". What this entails is not certain. Some have argued that a greater level of detail will be required than was required when setting out the "grounds" for withholding under the withholding notice regime. Unlike the withholding notice, the pay less notice cannot be combined with the payment notice. A *separate* pay less notice must be given.

New payment procedure

We have set out below a flowchart showing how the new payment procedure under the amended Act will operate. The payment procedure only applies to contract works for durations of 45 days or more, and must provide for instalments, stage payments or periodic payments. In the flowchart below, we have used an example where a contract states the contractor is to be paid £100,000, but the employer believes that the contractor has only done £70,000 of the work and, under the contract is able to pay for the amount of work one, rather than having an absolute obligation to pay the £100,000. (See Chart Below)…



Does payment under a construction contract have to be made if the payee becomes insolvent?

The amended Act provides that payment of a notified sum must be made on or before the final date for payment unless, firstly, the contract provides that a payer need not pay any sum due if the payee becomes insolvent and, secondly, the insolvency occurs between the date for the giving of a pay less notice and the final date for payment. So, if this is what the parties intend, it will need to be spelt out expressly in the contract.

What about the Scheme?

The Scheme contains provisions which are imported into construction contracts where they do not meet with the requirements set out in the Act. The Scheme has been amended to be compliant with the new regime and will also be effective from 1 October 2011 in England and Wales and from 1 November 2011 in Scotland. There will now be three different Scheme provisions: one for England, one for Wales and one for Scotland.

Amended standard form contracts

If you use standard form contracts as a basis for your own contracts then updated versions of those standard forms should be obtained. Publishers of some standard from contracts are planning to publish amended Act compliant amendments before 1 October 2011. Updated JCT contracts are currently available through the JCT website in tracked change versions, with the new edition to be published in September. NEC3 and ICC (formerly ICE) amended contracts are also expected to be available in September. FIDIC has not been drafted to be compliant with the Act, so, it is not likely that updated FIDIC contracts will be published as a result. However, if FIDIC is to be used for UK projects, all schedules of amendments thereto will have to be updated or contracting parties will take the risk that the Scheme will be imported into their contract, whether or not this is what they intended.

Conclusion and transitional measures

The amended Act has been a long time coming and the amendments only go part way to addressing the problems and achieving the aims of the Act. It may also be argued that the amended Act introduces more uncertainty with many of the provisions requiring careful consideration in order to ensure compliance with them.

In the light of the forthcoming changes, going forward construction contracts will need to be reviewed and possibly amended. Parties should look at their contract templates and take care when drafting new contracts to ensure compliance with the amended Act.

Parties who are negotiating contracts prior to 1 October 2011 should have in mind the regime that will come into effect. If the contract is being negotiated prior to 1 October 2011, but may not be entered into prior to that date, then the parties have the following options:

- enter into the contract anyway and rely on the Scheme for Construction Contracts (which imports compliant terms into the contract) where provisions are not compliant;
- redraft the provisions of the contract which are not compliant before the contract is entered into; or
- consider transitional measures so that all contracts are compliant without the need for significant redrafting.

The first option might give rise to uncertainty regarding the provisions which apply. The second option may be time consuming and possibly unnecessary depending on the point in time at which the contract is entered into. The third option is perhaps the simplest solution. Transitional measures could involve a separate addendum which sets out the changes to the contract which would be required by the amended Act together with a clause in the contract which provides that if the contract is entered into on or after 1 October 2011, then the contract is amended in accordance with that addendum. Such measures would, of course, only be necessary if the contract is not already compliant with the new Act.

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