Fenwick Elliott

PROPOSED GOVERNMENT REFORMS TO THE CONSTRUCTION ACT

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The government finally reveals its intentions for the reform of the adjudication and payment provisions within the Construction Act

It was probably some three years ago that people first began seriously to talk about possible changes to the Housing Grants Construction & Regeneration Act 1996 ("HGCRA"). Several consultations later and the government's plan to improve construction payment practices has been launched. Although the launch is by way of a further consultation process, given the short period of time given for responses, until 17 September 2007, it seems likely that these changes will be implemented fairly soon. We say no more than that because the government has made it clear that legislation to implement the proposals emerging from this consultation will be introduced only as soon as Parliamentary time allows.

The government proposals seek to introduce greater clarity and transparency into the statutory payment framework and to encourage parties to resolve disputes by adjudication. The key changes are as follows:

(i) Adjudication:

- The legislation will apply to oral and partly oral contracts and not just contracts evidenced in writing;
- The use of agreements that interim payment decisions will be conclusive is to be prevented; and
- Costs are to be fairly allocated

(ii) Payment

- The duplication of payment notices is unnecessary and to be brought to an end;
- The need to serve a section 110(2) payment notice is to be clarified;

- The content of payment and withholding notices is to be made clearer and must include details of any set-off or abatement;
- The prohibition of pay when certified clauses

(iii) Suspension

- The statutory right to suspend performance is to be improved by allowing the suspending party to claim the costs and delay which result from any valid suspension.

Contracts in writing

This is perhaps the most radical change. It is also the most surprising as it was not something which had been highlighted in previous consultation papers. This was even though there had been many who wanted changes to the legislation following the Court of Appeal decision in *RJT Consulting Engineers Ltd v DM Engineering (Northern Ireland Ltd) [2002] EWCA Civ 270* where the majority had held that section 107 of the HGCRA meant that all the essential terms of the contract needed to be in writing or evidenced in writing. However the call for change had to be balanced against the recognition concisely expressed by HHJ Bowsher QC in *Grovedeck Ltd v Capital Demolition Ltd* [2000] EWHC 139 (TCC) that:

"Disputes as to the terms, express and implied, of oral construction agreements are surprisingly common and are not readily susceptible of resolution by a summary procedure such as adjudication."

The difficulties caused by the *RJT* case can be seen in the recent decision of HHJ Wilcox who decided that the letter of intent in the case of *Bennett (Electrical) Services Ltd v Inviron Ltd* [2007] EWHC 49 (TCC) failed to comply with the requirements of section 107. However he also commented on the difference of opinion of the Court of Appeal in the *RJT* case noting that:

"…The reasoning of Auld LJ is attractive because at the subcontractor level and where cash flow difficulties are likely to be encountered in the smaller projects, the paperwork is rarely comprehensive. The extent of the requirement for recording contractual terms for an agreement to qualify under section 107 laid down by majority could have the effect of excluding from the scheme a significant number of those whom the Act was perhaps intended to assist."

The government's response is to follow the Australian and New Zealand approach and extend the HGCRA to contracts which are agreed wholly in writing, only partly in writing, entirely orally or varied by oral agreement. In other words, this removes the restriction of the application of the HGCRA to contracts in writing. However, if a contract does not set out provisions relating to a contractual adjudication scheme in writing, then as a default, the Scheme provisions will apply.

The driving force behind this change is that the "evidenced in writing" requirement was found to be acting as a barrier to the referral of disputes. The consultation paper noted that research

by TeCSA has found that of 154 recent enforcement cases, 15% related to whether the construction contract was evidenced in writing or not. Given the government's aim to extend the ambit of adjudication, the proposed extension of section 107 is a natural one. It will be interesting to see whether, the next time TeCSA carry out a similar survey, a large percentage of the disputes will revolve around what constituted the contract between the parties.

Interim Payment

The next change is that any agreement that a decision will be conclusive as to the amount of an interim payment will be deemed to be ineffective. Research had shown that some 15% of contracts provided for conclusive decisions in relation to interim payments. Accordingly, as this was felt to be a means of avoiding the referral of interim payment disputes to adjudication, in accordance with the government aims, such agreements had to go.

Costs

Here, the government is proposing to include new statutory provisions so that the following agreements are only valid if made in writing <u>and</u> after the appointment of the adjudicator:-

(i) Agreements that one party should pay the whole or part of the costs of the adjudication;

(ii) Agreements that the adjudicator may make a decision that a party should pay the whole or part of the costs of the adjudication

This is designed to prevent contractual provisions requiring the referring party to pay the costs of adjudication, a clear disincentive to commencing the adjudication process. Where a valid agreement has been made as described above, the adjudicator will be able to award only a reasonable amount in respect of costs reasonably incurred by the parties and, in respect of his fees, such reasonable amount as relates to the work undertaken and expenses incurred. Notwithstanding this, the parties shall remain jointly and severally liable for the adjudicator's reasonable fees and expenses. Interestingly, a combined DTi/CIC survey of adjudicators suggested that the average adjudicator's fees and expenses are approximately £5,000 per referral.

As the above provisions will be enshrined in statute, the government intends to remove all provisions about costs Part I of the Scheme, namely paragraphs 11 and 25, which entitle an adjudicator to his fees if his appointment is revoked or when he ultimately decides the dispute.

Payment

The problem with the section 110(2) notice, which sets out payments made or proposed to be made, was that under most contracts, the information in the notice tended to repeat the information already contained in the certificate. The government is therefore proposing that in order to prevent this unnecessary duplication, a notice or certificate from a third party can act as a section 110(2) payment notice.

That said, it is also intended to amend section 110 to make it clear that a payment notice is always required if a payment would have become due under the contract. This will be the case

even where there is no obligation to make any payment because the work has not been carried out or it has been set off or subject to abatement. Payment notices are seen by the government as an important tool in communicating details of payments which are made or are proposed to be made.

Further, the government intends to introduce clarity as to the content of the payment and withholding notices under sections 110 and 111. The proposal is that the payer must set out in a payment notice the amount (if any) that he is paying or proposes to pay. Where there is more than one ground, the payer will be required to set out each ground and the amount attributable to that ground. Although this might not seem new, you will be required to include details of any set-off or abatement, something which is currently not always thought to be necessary. The government is intending to achieve transparency about what constitutes the sum due.

The government wants to try and avoid the unnecessary issue of two notices when one (covering both payment and withholding) will suffice. In other words, a payment notice will be able to act as a withholding notice. Of course, some care will be needed, for example it will still be necessary to issue a separate withholding notice if the paying party decides before the latest date for the issue of that notice that it intends to withhold additional sums from those already stated in the payment notice.

Finally, the government intends to prohibit pay when certified clauses. This is to ensure that a certificate covering work under one contract cannot act as a mechanism to determine the timing of payment for work done under another.

Suspension

The problem with the right to suspend was that the compensation to which the suspending party is entitled under the legislation in the event of a legitimate suspension was not generous. The suspending party was merely entitled to an extension of time for completion of the works covering the period during which performance is suspended. That extension would not necessarily extend to the 7-day notice period prior to the right to suspend becoming operative nor would it apply to the time which it takes to re-mobilise following the suspension. This is important since the right to suspend ceases on payment of the amount "due" in full.

There was nothing to prevent the parties from conferring more extensive rights through the terms of the contract than the legislation provides. By way of example, clauses 25.4.17 and 26.2.9 of the JCT With Contractor's Design 98 form entitles the contractor to apply for both extensions of time in respect of "delay arising from a suspension…" and for "loss and expense where appropriate, provided the suspension was not frivolous or vexatious." However there was nothing to insist that the parties did this.

The government intends to make the right to spend performance a more effective remedy. Thus the party need not suspend all its obligations to the party in default and the government will provide a statutory right of compensation for any reasonable losses caused by the suspension. These costs may include damage to materials while clearing the site, storage

charges, management costs and the cost of retaining sub contract labour and hired plant and equipment. The aim is to make the right of suspension more accessible and effective.

A Coda

The government has also considered the recent House of Lords case of *Melville Dundas v Wimpey*. From a policy perspective, the government considers that section 111 should not apply in cases of insolvency. Thus, the government agrees with the House of Lords. However, section 111 should apply in all other cases. In other words, the *Melville Dundas* case should be construed narrowly on its own facts.

Of course there remain two unknowns. Will all these proposed changes actually be implemented and if so, when? That remains to be seen.

Full details of the proposed changes can be found on the DTi website at www.dti.gov.uk.

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