New statutory regime for Construction Contracts comes into force

Andrew Kearney and Rebecca Taylor ponder the long awaited new regime for payment, and the wider scope of 28 day Adjudication.

The amendments to the Housing Grants Construction and Regeneration Act 1996, generally known as the Construction Act 1996, finally come into force this weekend.

The amendments were introduced by the Local Democracy, Economic Development and Construction Act 1999. They were the subject of wide consultation before the LDEDCA was passed and have been widely discussed ever since - for example, Andrew Kearney addressed the Adjudication Society on them as long ago as January 2010. A revised Scheme for Construction Contracts has now been produced, the necessary Amendment Regulations and Commencement Orders made, and it all finally comes into force on Saturday 1 October 2011. The new regime will apply to all construction contracts made on or after that date. The old regime will continue to apply to all construction contracts made before 1 October. On some current projects the likelihood is that some contractors or subcontractors will be on the old regime and some on the new.

All those involved in the construction and engineering sectors, and those advising them, need to be aware of the changes. They bring with them both risks and opportunities.

The most important changes include -

- The Construction Act (as amended) will now apply to all "construction contracts" - regardless of whether they are made or evidenced in writing. The old exclusions will remain - for example, contracts with residential occupiers, and some energy related contracts are not "construction contracts" - but huge numbers of informal, part oral or orally varied contracts and subcontracts will now come within the Act for the first time. Rok v Bestwood for an example of how a decision in such a case was unenforceable on the old regime)

- The mandatory 28 day Adjudication process will now apply to all these contracts. For the first time, Adjudicators will have the power (and duty) to

decide disputes about the making or terms of the contract, as well as all of the other disputes with which they have been used to dealing. Many people think that this will mean that Adjudicators are more likely to have to hold hearings or meetings to assess the credibility of witnesses where there is a dispute about what was agreed.

- A mandatory new payment regime will apply to all construction contracts where the work is expected to take longer than 45 days. Under the new regime, a party applying for payment can become contractually entitled to the sum applied for - whether or not it is the correct sum - if appropriate counter notices are not served on time. This has been causing enormous concern to many main contractors, who are having to tighten up their contract terms and their systems to ensure that applications for payment are made when and in the form expected, and are then properly processed.

- The right to suspend work for non payment has been made more effective. Now, there is a right to suspend performance of either some or all obligations, and also a right to extra time and money linked to the suspension. This deals with some of the problems in the old regime which had led to the suspension right being rarely exercised.

Adjudication. New Opportunities for Parties ? New Risks for Advisers ?

It has often been said that conflict and dispute are endemic in the construction industry. When the Construction Act 1996 created an automatic right to adjudicate in written construction contracts made after May 1998 there was a boom in lower value disputes. Instead of waiting for months or even years for a decision in Court, a disappointed subcontractor (for example) could get a binding decision in a little over a month. It suddenly seemed worth having a go. Most decisions were honoured. Where they were not the Courts would enforce them within weeks (or sometimes even days) using a special procedure.

The old regime only applied to contracts made or wholly evidenced in writing. In many cases Adjudicators were asked to resign when it appeared that any small part of the agreement between the parties was not recorded in writing. In other cases, barristers,

solicitors, claims consultants and other advisers simply ruled out Adjudication as a dispute resolution option for the same reason.

All this has now been swept away. The path is now open for any party to any future "construction contract" to use 28 day Adjudication as their chosen method of dispute resolution. This may mean that Adjudicators spend less time dealing with jurisdiction challenges, and more time resolving disputes.

Adjudicators have a statutory power to "take the initiative in ascertaining the facts and the law" - to act fairly but inquisitorially. It seems to be rarely used. It will be interesting to see whether this power becomes more widely used - in particular in lower value cases and where the contract terms themselves may be in dispute.

What is clear is that, quite deliberately, Adjudication has been made more widely available. All industry participants need to be aware of this - it will create both risks and opportunities for them. All those who advise developers, contractors and subcontractors now have an additional weapon in the armoury in every "construction contract" case - but need to ensure that they are fully informed in respect of the Adjudication process, or have access to specialist help.

Andrew Kearney and Rebecca Taylor are both Technology and Construction Bar Association accredited Adjudicators. Andrew is also accredited by the Technology and Construction Solicitors Association. They and some other members of the Construction and Engineering team in Chambers have experience in Adjudication and in Adjudication Enforcement.

The New Payment Regime

The new provisions are mandatory.

Many column inches have been spent in the trade press dealing with the new payment regime. It is a little complex, and there are pitfalls. We can advise on individual cases. We can also either advise on, or recommend suitable solicitors who can assist in redrafting, payment terms to comply with the mandatory new procedure, and avoiding some of the traps.

Most large organisations are on top of this. There has been plenty of warning, the industry standard form contracts have been redrafted, and many organisations have amended their own bespoke terms.

However, the new mandatory regime will apply to every "construction contract" where the work is expected to take more than 45 days - even when there is no written contract at all. In these cases, the fallback provisions of the (amended) Scheme for Construction Contracts will apply. As a result, all industry participants and advisers need to know the new rules, and ideally those applying for and (in particular) those making payments should have compliant systems in place.

The days of the old regime and a paying party's s110 Payment Notices and s111 Withholding Notices are now numbered - the old provisions apply only to existing contracts made before 1 October. The old regime was primarily concerned with establishing the sum properly due, and applying any set off properly notified. The s110 Payment Notice provisions lacked any sanction for non compliance, and were commonly ignored.

Under the new regime applying to contracts made from 1 October the focus changes from the sum due to the sum applied for. If the appropriate notices are not served a situation can arise where regardless of what is properly due the receiving party becomes entitled to the sum applied for without deduction - and entitled to suspend performance if the paying party does not pay in full. There are likely to be battles in future over whether applications in such circumstances were made in good faith or deliberately inflated, and the effect of that - but it seems likely that anything short of a deliberate over application amounting essentially to fraud will give rise to enforceable rights to payment.

All clear ?

Despite all the time that has been spent on the changes, there is both ongoing controversy and scope for future 'disputes about disputes'.

There will inevitably be disputes about the permissible scope of bespoke contractual clauses which try to place preconditions on what will be treated as a valid application. Some of these may go too far in trying to sidestep the intentions of the new Act.

A statutory bar has been introduced on clauses (known as Tolent clauses after the leading case) which provided for one party to pay the costs of the Adjudication - even if they win ! These clauses were regarded by many (including in recent cases an English TCC Judge, but not a Scottish one) as contrary to the spirit and true meaning of the Construction Act. There is however a residual ongoing controversy in the trade press about whether the new clause (s108A) has been misdrafted and has the opposite effect to that intended. Until that is resolved some contractors may be tempted to continue to insert standard clauses requiring their subcontractors to bear all the costs of any adjudication. It seems unlikely that these will be enforceable.

What Now ?

After the initial flurry of activity on contract drafting, things will no doubt settle down for a while until we start to see the first disputes arising under post 1 October contracts in a few months time. It will probably be at least 6 months before a regular stream of disputes and reported cases start to appear under the new provisions.

In the meantime, we suggest that the first thing any party or adviser should do when considering any dispute or potential claim is to look carefully at the contract formation, bearing in mind the key date of 1 October 2011 and that the "in writing" requirement still applies to all pre October contracts.

The changes are not so much a revolution as a minor uprising, intended to be improvement. We have known they are coming for a long time. There is still time to get to grips with them ….. but it is running out.

Andrew Kearney and Rebecca Taylor are Barristers in St John's Chambers Construction and Engineering team.

andrew.kearney@stjohnschambers.co.uk
rebecca.taylor@stjohnschambers.co.uk

September 2011

St John's Chambers