

SEC GROUP *briefing*

Voice of the Specialist Engineering Contractor

The members of the
SEC Group are:

Association of
Plumbing and Heating
Contractors

British Constructional
Steelwork Association

Electrical Contractors'
Association

Heating and Ventilating
Contractors'
Association

Lift and Escalator
Industry Association

SELECT

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CONSTRUCTION ACT CONSULTATION UNDERWAY

The Department of Trade and Industry (DTI) has published a consultation document (CD) on proposals to amend the Construction Act. The proposals arose out of a review carried out by Sir Michael Latham last year. The review was prompted by an announcement by the Chancellor of the Exchequer in his March 2004 Budget Statement that the Act should be reviewed to identify changes that would help overcome payment problems in the construction industry.

It should be noted that the consultation exercise only applies to England and Wales. The deadline for responses is **21 June 2005**. The Scottish Executive is still to announce when the consultation process will start in Scotland.

The CD can be downloaded from the DTI's website: www.dti.gov.uk

The title is *Improving Payment Practices in the Construction Industry*

PAYMENT

The CD has 8 proposals to improve payment

- 1 The Act to define the requirements of an adequate mechanism for determining what and when payments become due – all contracts should reflect such requirements.**
- 2 Removal of existing requirement for a payer's notice telling the payee of the amount the payer proposes to pay.**

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- 3 A statutory right for a payee to apply for payment.
- 4 Withholding notices to state the balance to be paid to the payer after withholding.
- 5 Use of pay-when-certified clauses to be restricted to where a sub-contractor's work is priced in the certificate.
- 6 A right to compensation for a period of suspension for non-payment and for re-mobilisation together with additional time for remobilisation.
- 7 Cross-contact set-off to be ineffective.
- 8 Amendment to the payment rules in the Scheme for Construction Contracts (the fallback scheme) so that interim payments include value of materials part-assembled off-site specifically for the project.

NB: *Making pay-when-paid clauses ineffective in cases of upstream insolvency proceedings – DTI is reluctant to proceed with this since there is no evidence that this would provide a fairer outcome for the industry as a whole.*

PAYMENT

ISSUES ON WHICH THE DTI IS NOT CONSULTING

- A proposal agreed in the review that clients should have the right to pay sub-contractors directly in the event of main contractor insolvency.
- A long-stop period for payments to curb lengthy payment periods aimed at avoiding the legislation.

ADJUDICATION

The CD proposes 4 changes to the adjudication provisions

- 1 **Banning the use of trustee stakeholder accounts that require adjudicators to pay disputed monies into such accounts pending arbitration/litigation – unless the recipient of the monies is involved in insolvency proceedings.**
- 2 **Giving the adjudicator power to decide whether he has jurisdiction over the following matters:**
 - Is there a construction contract?
 - Is there is a dispute?
 - Was the adjudicator properly appointed?
- 3 **Giving the adjudicator power to re-open “final and conclusive” decisions/certificates where these relate to interim payments.**
- 4 **Extending the adjudicator’s immunity to third party claims.**

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ADJUDICATION

ISSUES ON WHICH THE DTI IS NOT CONSULTING

- A single adjudication procedure for all adjudications
- Ban on contractual provisions requiring a party to pay the other party's costs of adjudication and on the adjudicator having power to award "party and party" costs [the DTI is already committed to legislate on these matters]
- Amendment to the Act to change a Court of Appeal decision that the Act only applies to contracts that are wholly in writing.

GENERAL COMMENTARY

THE PAYMENT PROPOSALS

PROPOSALS 1 – 5

It is logical to lump proposals 1 – 5 (inclusive) together since they go to the heart of the problem as far as the Act's payment provisions are concerned.

What does the Act now say about payment entitlement?

- All contracts to have an adequate mechanism for determining **when** and **what** payments become due.
- Not later than 5 days after the due date for payment the payer must give written notice of the amount he intends to pay with the basis of the calculation.
- A final date for payment must be stated in contracts in respect of due payments.
- A payer can only withhold monies from sums otherwise due by issuing a notice of withholding before the final date for payment.

The Act assumes that by the final date for payment a payee will know where he stands as far as his payment entitlement is concerned:

- A notice of withholding – insofar as it concerns set-off – assumes that a debt has already arisen; and
- The right of suspension for non-payment assumes there is a debt at the final date for payment.

But, in the majority of situations, the payee does not have payment certainty (ie a debt) by the final date for payment. The payer rarely bothers to issue a notice of the amount he intends to pay – there is no sanction for the non-issue of this notice. Even if such notice is issued it will not be the payee's entitlement if the payee disagrees with the amount.

SEC Group's Proposals

During the course of the review SEC Group proposed that section 110 should comprise a procedure that would facilitate crystallisation of a debt by the final date for payment:

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- The payee to have a statutory right to apply for payment in respect of the work and services to be provided under the contract;
- The payer to have the right to challenge the amount applied for by the issue of a withholding notice before the final date for payment;*
- The amount in the payee's application or the difference between that amount and any lesser amount withheld shall constitute a debt on the final date for payment.

** Provided that there is a notice of withholding complying with the Act.*

The above proposals have the merit of simplicity, clarity and certainty as well as fairness to both parties.

The CD proposes that the Act should set out the elements of an adequate mechanism:

- What amounts constitute payment under the contract;
- When a payment is to be assessed under the contract;
- How the amounts are to be determined.
- The time between the point at which payments are to be assessed (the "assessment date") and the final date for payment.
- The information about payment entitlement to be communicated between the parties.

All these elements should then be addressed in the contract.

There are a number of difficulties with this approach:

- The payee has to make a decision on whether all these elements are properly applied in the contract; such decision will often be difficult.
- More importantly, even if the contract is compliant, the payee will still not know where he stands on the final date for payment if the payee disagrees with the value that the payer has placed on his work and/or services rendered.

The 5 day payment notice

The CD proposes that the 5 day payment notice should be removed because it is rarely issued. The removal of the notice will only be acceptable if the Act was to be amended in accordance with SEC Group's proposals above.

Statutory right to apply for payment

On the other hand, the CD does suggest that a payee should have a statutory right to make an application for payment. Whilst this is welcome, it would only be effective - so far as crystallising a debt is concerned - as part of SEC Group's proposals.

Withholding notices

It is unclear how matters would be helped by proposal 4 in the CD that all withholding notices should state the remaining amount that the payer intends to

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pay after withholding the notified amount. DTI is reluctant to accede to the suggestion that withholding notices should contain sufficient detail of the reasons and calculations behind the withholding. Perhaps, the legislation should require that withholding notices include:

- When the loss or damage was incurred;
- A breakdown of the items giving rise to the claim for loss/damage;
- How the total amount withheld was calculated.

Pay when certified

It is generally acknowledged that pay-when-certified provisions were introduced as a way of getting round the ban on pay-when-paid. But, DTI suggests that pay-when-certified clauses should be permitted subject to certain conditions – the main one being that the sub-contract rates are referred to in the certificate. However, this only occurs within the JCT Management Contract package and the rarely-used JCT nominated sub-contract documentation. Any limited acceptance of pay-when-certified provisions would simply legitimise the use of such provisions. Moreover the sub-contractor does not have a direct remedy against the payer or certifier under a main contract in the event of late or non-issue of a certificate.

PROPOSAL 6

There was general agreement within the review process that there should be a right to reimbursement for the reasonable cost of suspension for non-payment and for remobilisation and to allow time for remobilisation. The CD suggests that a figure of 5% of the value of the outstanding payment would be an appropriate level of compensation and that a maximum number of 7 days should be allowed for remobilisation.

Are these figures acceptable? Tell your association.

PROPOSAL 7

There was general consensus in the review on the need to outlaw cross-contract set-off. This arises where a notice of withholding on contract X is in respect of sums claimed under the contract Y. The CD proposes a ban on these clauses.

PROPOSAL 8

During the course of the review SEC Group proposed that the statutory right to interim payments in section 109 of the Act should be expressed to commence from the date of agreement to provide the requisite work and/or services. This was to encourage payment for assembly, manufacture and design carried out prior to on-site work. In the CD the DTI seems to have missed the point. Instead it proposes an amendment to the rules in the Scheme for Construction Contracts to enable materials off-site to be included in the calculation of interim payments.

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PAY-WHEN-PAID CLAUSES

The DTI is reluctant to remove the current exception to the ban on pay-when-paid that allows, for example, a main contractor to rely on a pay-when-paid clause in the event of a client going into insolvency. This exemption does not occur in similar legislation passed in Australia, New Zealand and Singapore.

ISSUES ON WHICH THE DTI IS NOT CONSULTING

Payment Security & Insolvency

It was agreed in the review that the Act should give a right to a client to re-direct payments to an insolvent contractor to creditor sub-contractors (provided that the client does not run the risk of double payment). DTI is against this since it would have the effect of making construction a special case under insolvency law. The law requires that all creditors of the same ranking are treated equally.

This stance is surprising in view of recent high-profile insolvencies in the industry which have left many firms significantly out of pocket. We should be insistent that there are provisions in the legislation that provide a measure of protection against the consequences of insolvencies upstream. There already exists such protection in Europe, North America and Australia.

Statutory Long-Stop Payment Period

SEC Group has advocated the inclusion in the legislation of a long stop period to curtail excessive payment periods aimed at avoiding the impact of the legislation. In the CD the DTI is opposed to this on the basis that parties should be free to agree their own payment periods. But, since the Act came into force payment periods have increased in length which should provide sufficient justification for a statutory long-stop period.

ADJUDICATION PROPOSALS

PROPOSALS 1 – 3

During the review SEC Group was concerned to ensure that adjudication remains accessible to all and, in particular, that it is quick and relatively inexpensive. Furthermore, the opportunities for challenging decisions of adjudicators should be reduced.

Proposals 1, 2 and 3 are designed to achieve these aims. However, there are some concerns:

- Trustee stakeholder accounts should be outlawed even where the recipient of monies awarded by the adjudicator is involved in insolvency proceedings. Often the reason for this is that the recipient has been deprived of the money that the adjudicator has awarded.
- The adjudicator should also be allowed to determine whether there is a contract and whether it satisfies the requirement of writing (see next page);
- All clauses making decisions/certificates “final and conclusive” should be outlawed – there are often vast sums of money outstanding at the final account stage (especially for variations and extras) and, therefore, it would be wholly inappropriate for a decision on the final payment to be made “final and conclusive”.

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ADJUDICATION

ISSUES ON WHICH THE DTI IS NOT CONSULTING

A single adjudication procedure for all adjudications

This was a key issue for SEC Group and, indeed, there was a consensus in the review process for having one statutory procedure for adjudication rather than the myriad contractual procedures primarily aimed at reducing access to adjudication. The reasons for omitting this proposal are not given. This must be insisted upon by respondees.

Meaning of contracts in writing

In the case of R J T Consulting v D M Engineering the Court of Appeal decided that the Construction Act should only apply to contracts that are wholly in writing or where there is evidence of all the terms of the contract. The Court felt that adjudicators would not have the time to look into what was actually agreed between the parties – a view supported by the DTI. The consensus reached in the review process was that it should be left to the adjudicator to decide whether the contract was sufficiently in writing to satisfy the requirements of the Act.

The major flaw in the Court of Appeal's view was that an adjudicator will not need to spend time working out all the terms of the contract; in the vast majority of situations one would only need to establish the terms that were agreed in relation to the dispute. Otherwise, a claimant owed a substantial sum of money would not be able to refer the matter to adjudication because the other party was alleging that agreement had been reached on some unrelated matter that had not been reduced to writing.

Respondees should insist that adjudicators have the power to decide whether a contract is sufficiently in writing for the purposes of the Act

Enforceability of adjudicators' decisions

This issue was not discussed in the review process and, therefore, is not in the CD. However the Act needs to make clear that adjudicators' money decisions should be enforced as a debt free of set-offs and counterclaims.

EXCLUSION OF PROCESS PLANT CONTRACTS

The CD states that there are a number of differences between the process plant and construction industries. But, there is no indication that these differences (whatever they might be) are such that process plant requires different treatment. There are countless anomalies in the Act that need to be resolved. For example, supporting steelwork for the plant is excluded from the scope of the Act but not concrete or blockwork. It is suggested that guidance is issued on the implications of case law on the dividing line between those parts of process plant included in the Act and those not included. Such guidance would be



meaningless since all the cases were decided on the individual factual situations and, therefore, do not give rise to any general principle.

NEXT STEPS

- SEC Group to develop a response to the CD to be agreed by member associations.
- Member associations to draft their own responses.
- Member firms to draft their responses with help from their associations and SEC Group.

IT IS ABSOLUTELY VITAL THAT FIRMS RESPOND TO THE CD. THIS IS A UNIQUE OPPORTUNITY TO IMPROVE THE ACT TO ACHIEVE CERTAINTY OF PAYMENT ENTITLEMENT AND SECURITY OF PAYMENT.

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