

## **PAYMENT PROVISIONS UNDER THE CONSTRUCTION ACT**

Long awaited changes to the Construction Act came into force on 1 October 2011. This briefing highlights the main changes to the payment provisions.

### **Background**

On 1 May 1998 Part II of the Housing Grants, Construction and Regeneration Act 1996 (known as the Construction Act) (“the 1996 Act”) came into force. It contains provisions to speed up the flow of payments and information about payments in construction contracts, and also introduces a new dispute resolution procedure of “adjudication”. This note considers some of the payment provisions.

Contracts for most types of building work are covered by the Act, but it excludes (amongst others) contracts: with residential owner occupiers; for mining; for oil or gas drilling; for artistic works; of employment; for supply only and those not in writing. Further exclusions are made by Order under the 1996 Act, particularly excluding some types of PFI and finance agreements.

### **Payment**

The 1996 Act provides parties with an entitlement to periodic payments throughout the contract works, where the work is to last 45 days or more. If the contract does not provide an adequate mechanism for calculation of the amount of and timing of payments (providing for a due date and a final date for payment) then a scheme imposed by the 1996 Act will apply, further details of which appear below.

The 1996 Act requires payment notices in two instances:

- not later than 5 days after the due date notice of the amount to be paid must be given by the paying party
- notice of intention to withhold payment must be given as a pre-condition to set off or deduction at an agreed time before the final date for payment

Other payment provisions include:

- Pay when Paid clauses will be ineffective except where any paying party in the payment chain becomes insolvent

- an unpaid party may suspend performance upon 7 days' prior written notice if payment remains outstanding after the final date for payment and no effective notice of intention to withhold payment has been served.

## **Scheme**

Where the contract does not contain terms to deal with the matters required by the 1996 Act then the provisions of the Scheme for Construction Contracts (England and Wales) Regulations 1998 (SI 1998 No 649) will apply ("the Scheme"). The following describes the provisions of the Scheme.

Where the work is to last 45 days or more:

- instalments/stage payments will be due for the relevant period. Unless the contract provides a period the relevant period will be 28 days
- payment falls due on the later of 7 days after the period or the date of claim by the payee
- the amount due is the value of work done in the period and materials supplied
- final payment is due not later than 30 days after completion of the work or application if later
- final date for payment will be 17 days from due date

Where the work is to last less than 45 days the payment period is 30 days from completion.

Ultimately, the detail of the payment provisions as to amount and frequency is a matter for the parties to the contract. The main standard forms have their own provisions to satisfy the requirements of the Act. However, the scheme provides a useful default mechanism for the contracting parties.

Since the introduction of the 1996 Act there has been much case law clarifying various aspects of the 1996 Act and the Scheme. The notice of intention to withhold payment has been regarded as crucially important and a failure to serve one will lose the paying party a right to withhold payment by reason of set off or counterclaim. By contrast, the notice of the amount to be paid has proven to be of less significance.

The 1996 Act has been regarded as a success and following a review changes were made to it that affect all construction contracts made on or after 1 October 2011. These changes were implemented by amendments to the 1996 Act brought in by the Local Democracy, Economic Development and Construction Act 2009 (the "2009 Act").

## **Changes under the 2009 Act**

### *Contracts covered*

The scope of contracts covered by the Act was extended to include oral contracts. The requirement under the 1996 Act that only contracts made or evidenced in writing are caught went. This requirement had in effect excluded many contracts which were recorded partially in writing and so far more contracts are now subject to the payment requirements and Scheme. Many more professional appointments are now caught than was previously the case and smaller projects where the paperwork has not been put in place are now subject to the 2009 Act.

### *Notices*

The 2009 Act replaces the 1996 Act's notice requirements with a new regime. The 2009 Act requires that a contract must provide for a payer (or a "specified person" such as an architect or engineer) to give a payment notice or it may require the payee to do so.

Where a payer (or specified person) is to give notice:

- the contract must require the notice to be given not later than 5 days after the payment due date setting out the sum it considers to be due at the payment due date and the basis on which it is calculated (even if that sum is zero)
- the payer (or specified person) may then serve a notice of intention to pay a lesser sum than that set out in the payee's notice setting out the sum the payer considers to be due at the payment due date and the basis on which it is calculated (even if that sum is zero) (a "Pay Less Notice"). Such notice must be served by an agreed time before the final date for payment or in the absence of agreement, the date set out in the Scheme (which is no less than 7 days before the final date for payment)

The sum due by the final date for payment is the sum set out in the Payer's notice or if one is given, the sum set out in the Pay Less Notice. If an adjudicator decides a higher sum is payable, that higher sum becomes the sum due by the final date for payment.

If the payer (or specified person) fails to give such notice:

- the payee may give its own notice, as above
- the final date for payment is then delayed by the same number of days after the time the payer's notice should have been given until the date of the payee's notice
- the payer (or specified person) may then serve a Pay Less Notice (as above)
- If a Pay Less Notice is served, the sum due by the final date for payment is the sum set out in the Pay Less Notice
- If a Pay Less Notice is not served, the sum due by the final date for payment is the sum set out in the Payee's notice

Where the contract provides that the payee is to give notice, the procedure is as outlined above save that there is no delay to the final date for payment.

The changes from the 1996 Act therefore meant that withholding notices are no longer required and are replaced with pay less notices. Whereas under the 1996 Act regime a payment notice was often not given, it is of crucial importance under the 2009 Act.

#### *Conditional payment*

The 1996 Act banned pay when paid clauses, save for cases of insolvency, but did not forbid pay when certified clauses. The 2009 Act addresses this by providing that payments under a construction contract cannot be conditional upon the performance of obligations (for example completion of work) under another contract or a third party's decision that these obligations have been performed under another contract. The prohibition does not apply where the contract is an agreement for carrying out construction operations by another person whether under sub-contract or otherwise and the obligations which are to be completed in order for a payment to become due are construction operations.

#### *Suspending work*

The right to suspend work under the 1996 Act is extended under the 2009 Act by allowing for suspension of “*any or all*” of the work. This gives the suspending party the option of continuing with some parts of the work during the suspension period. In addition, the 2009 Act provides that a party exercising a suspension right is entitled to recover a reasonable amount of costs and expenses incurred in exercising that right. This clarifies the position over remobilisation costs which the 1996 Act had been silent upon. It also expands the right of the suspending party in relation to contractual time limits for performance of work. In addition to disregarding the period of suspension, the time spent in consequence of the exercise of the right of suspension is also to be disregarded.

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*This information is necessarily brief and is not intended to be an exhaustive statement of the law. It is essential that professional advice is sought before any decision is taken.*