Fenwick Elliott
The construction & energy law specialists
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Welcome to the August edition of **Insight**, Fenwick Elliott's latest newsletter, which provides practical information on topical issues affecting the building, engineering and energy sectors.

In this issue find out what you need to know about the New Construction Act & Revised Scheme

Insight

The New Construction Act & Revised Scheme

After months of speculation, it has been announced that Part 8 of the *Local Democracy, Economic Development and Construction Act 2009* (the "New Act") and the *Scheme for Construction Contracts (England and Wales) Regulations 1998* (as amended) (the "Revised Scheme") will be implemented in England and Wales on 1 October 2011.

The purpose of this note is to provide a summary of the most important changes and to consider the likely impact of the New Act and Revised Scheme on construction industry practice as a whole. As is the case currently, the Revised Scheme will be implied into any construction contract that is not New Act compliant.

What will be affected?

Only construction contracts entered into on or after 1 October 2011 will be affected. That said, there will be an interim period during which you may find that some documentation on a single project will be governed under the Housing Grants, Construction and Regeneration Act 1996 (the "Old Act") and other project documentation falls under the New Act. This is because sub-contracts and professional appointments are often executed some months after the building contract. Care should therefore be taken to ensure that all contracts in the chain are consistent following the introduction of the New Act to prevent any problems (particularly payment related) cropping up later down the line.

What will change?

New payment regime

A new, notice led payment regime has been introduced by the New Act, the starting point for which is the payment due date.

The procedure and key points to note may be summarised as follows:

Procedure

- Payment Notice due from Employer / Main Contractor or appointed agent, for example, Architect, QS or Engineer ("Payer") or Contractor or Sub-Contractor ("Payee") (if the contract so provides) within 5 days of due date for payment (under the Revised Scheme) or as otherwise provided by the contract. Payment Notice due even if sum due is zero and must state the sum which is considered due and the basis on which that sum is calculated.

- If no Payment Notice is served, any preceding Payment Application issued by Payee will qualify as the Payment Notice. If the Revised Scheme applies, the Payee may issue a Payment Notice of its own.

- If no Payment Notice is issued, or the Payment Notice issued is considered to be invalid, the Payee must immediately issue a Default Payment Notice. Final date for payment will then be extended by the number of days between the date on which the Payment Notice should have been served and the date of service of the Default Notice. Default Notice must state the sum which is considered due and the basis on which that sum is calculated.

- If the Payer wishes to dispute the sum due in the Payment Application, Payment Notice, or Default Payment Notice, the Payer may serve a Payless Notice 7 days before the final date for payment (under the Revised Scheme), or as otherwise provided by the contract. The Payless Notice re-values the work as at the date of service of the Payless Notice and can include LADs, set offs and abatements. A Payless Notice cannot be served unless the Payee has already served a Default Notice and must state the sum which is considered due and the basis on which that sum is calculated.

Key points

- To be valid, all Notices must state the sum which is considered due and the basis on which that sum is calculated. Currently, only the "ground" for withholding is required. "Basis" for payment may be wider in scope than "ground" and Notices which do not contain a breakdown of the sum due and detailed grounds for withholding may be rendered invalid, in which case the last served valid Notice will stand.
- If a Default Notice is served and no Payless Notice is served, it is important to note that the Payee's Payment Application, Payment Notice or Default Notice will stand.
- If a Payless Notice is not served, it will no longer be possible for the Payer to dispute the sum due on the basis that the work was not done, or was defective.
- The most important point to note about the new payment regime is that the last valid Notice will dictate the sum due and the Notices will therefore be determinative.
- Withholding notices will no longer exist and a Payment Notice cannot be combined with a Payless Notice.
- The only situation in which the sum due will not be payable following service of a Payless Notice is if (1) the Payee becomes insolvent during the period between service of the Payless Notice and the payment due date and (2) the contract allows for withholding of sums due in the event of insolvency.
- Contracts must still provide for stage payments and there must be an "adequate mechanism" for determining payments.
- With the exception of PFI sub-contracts and management contracts, "Pay-when-certified" clauses will be outlawed. Payment will not be able to be made conditional on other contracts as this would not constitute an "adequate mechanism" under the New Act.

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Improved suspension rights for non-payment

The New Act introduces a right of partial suspension upon (1) the provision of seven days' written notice and (2) service of a Default Notice. This will be of particular use in the event of non-payment by the Payer and partial suspension will probably be invoked as a tactical alternative to adjudication in order to secure payment.

A contractor may, for example, elect to refuse to implement a change request if agreement is not reached as to its status, and continue with the remainder of the project without risking being in repudiatory breach of contract.

Not only will contractors have the right to suspend part or all of their obligations, but they will be entitled to an extension of time and any reasonable costs and expenses incurred in exercising the right to suspend (assuming the suspension is valid) in line with many standard forms of contract. However, any recoverable costs would probably be limited to direct as opposed to consequential costs and loss of profit. Any legal costs associated with the suspension would not be recoverable unless specifically contemplated by the contract.

Contracts no longer in writing

One of the key changes in the New Act is that construction contracts will no longer have to be "in writing" to fall within its remit. This means that contracts that are (1) wholly in writing which have subsequently been amended orally (2) partly in writing and partly oral and (3) wholly oral will become subject to the payment and adjudication provisions within the New Act.

Parties to contracts with an oral element may find themselves at an increased risk of disputes since new issues may arise as to whether (1) there was a contract in existence at all (2) the oral element of the contract was incorporated into the written contract and (3) the terms of any oral contract. Inevitably, Letters of Intent will also be contentious.

Adjudication provisions must be in writing under the New Act and therefore regardless of the fact that a contract was concluded orally, any agreement to refer these issues to adjudication must be documented in writing and comply with the Old Act.

To avoid the difficulties which will undoubtedly arise with oral or partially oral contracts, tender reviews, notes of pre-contract meetings, and all pre-contract discussions should be marked "subject to contract" to avoid a contract being created inadvertently. In Immingham Storage Company Ltd v Clear plc [2011] EWCA Civ 89, the Court of Appeal held that the words "a formal contract would then follow in due course" were sufficient to create a binding contract in circumstances where all essential terms of the contract had been agreed, the necessary internal approval had been obtained and, notably, the negotiations were not conducted "subject to contract".

Contracts can be created in circumstances where one party holds a genuine view that no formal contract was ever concluded and following the Immingham case it is more important than ever that the words "subject to contract" are used as standard.

Adjudication timetable

The Revised Scheme amends the adjudication timetable slightly in that it requires the adjudicator to advise the parties of the date on which he received the Referral Notice. The date for reaching a decision will then be calculated from this date.

Adjudication costs

Under the current regime, it is open to parties to agree who will pay the costs of the adjudication prior to service of the Notice of Adjudication (such clauses are commonly referred to as "Tolent Clauses") but these clauses have a tendency to act as a fetter to the statutory right to adjudicate "at any time". This is because contractors usually assume responsibility for adjudication costs regardless of the outcome, which is particularly onerous in the current economic climate.

The New Act and Revised Scheme permit parties to confer power on the adjudicator to allocate and apportion responsibility for his own fees and expenses between the parties.

In so far as the parties' own costs are concerned, parties will also be able to agree liability for these following service of the Notice of Adjudication, albeit an apportionment would be very difficult to agree in practice in the midst of a dispute.

The New Act is notably silent on whether a single clause which (a) confers power on the adjudicator to allocate his costs between the parties and also (b) permits the parties to allocate responsibility for their costs prior to service of the Notice of Adjudication, would be permitted.

This issue will probably fall to be considered by the Technology & Construction Court ("TCC") once the New Act is in force. Parties will probably try and circumvent the true intention of the New Act (which was to outlaw Tolent Clauses), but the TCC has historically been reticent to accede to technical arguments and it would be more likely to support Parliament's intention. Once this issue is referred to the TCC for determination, the final death knell for Tolent Clauses may well be rung.

The Slip Rule

Finally, the New Act codifies the common law position in regard to slips, namely that an adjudicator can correct a slip (an accident or omission in the decision), within a reasonable period of time in accordance with the decision in Bloor Construction (UK) Ltd v Bowmer & Kirland (London) Ltd (TCC) [2000] BLR 314.

The New Act provides that a construction contract must include a slip provision which gives power to an adjudicator to correct typographic and clerical errors (including miscalculations) in the decision. Under the Revised Scheme, the decision must be corrected within five days of delivery of the original decision to the parties.

Conclusion

The key to avoid being caught unawares by the New Act and Revised Scheme is familiarity with the new "battle of the forms" payment regime by which the last valid Notice will trump all previous Notices.

Care should be taken in pre-contract discussions to ensure that negotiations are conducted strictly on a "subject to contract" basis to prevent inadvertently creating a binding contract and falling within the payment and adjudication provisions under the New Act and Revised Scheme.

If at all possible, oral contracts should be avoided to prevent possible new issues from arising as to whether a contract was concluded at all, and if so, upon what terms, both of which would be ripe areas for arguments on jurisdiction in adjudication.

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