

# **LOCAL DEMOCRACY, ECONOMIC DEVELOPMENT AND CONSTRUCTION ACT 2009**

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## **EXPLANATORY NOTES**

### **COMMENTARY**

#### **Part 8: Construction Contracts**

##### **Introduction**

308. Part 2 of the Housing Grants, Construction and Regeneration Act 1996 (“the 1996 Act”) concerns “construction contracts”. Pursuant to section 104, these are agreements for the carrying out of “construction operations”. Construction operations include the construction, alteration, repair, maintenance, extension, decoration and demolition of buildings; preparatory work such as site clearance, earth-moving and excavation; and the installation of fittings such as heating, lighting, drainage and sanitation systems (section 105). Contracts with householders are excluded, however. As originally enacted, Part 2 only applied to construction contracts which were “in writing”.
309. Section 108 of the 1996 Act gives each party to a construction contract the right to refer a dispute to “adjudication” and requires the parties to include terms in their contract relating to adjudication. These include terms enabling either party to give notice to the other at any time of the intention to refer a dispute to adjudication; ones requiring the adjudicator to reach a decision within a certain time period; and terms providing (in the absence of contrary agreement) that an adjudicator’s decision is binding in the interim. Section 109 of the 1996 Act provides that contractors (those performing the work) are entitled to periodic payments (unless the work is or is estimated to take less than 45 days). Section 110(1) stipulates that construction contracts are to contain an “adequate mechanism” for determining what and when payments become due under the contract and are to provide, in respect of each such payment, a final date by which settlement must be made – the “final date for payment”. As originally enacted, section 110(2) required the payer to give the contractor/payee notice (in advance of each payment) of the sum which he proposed to pay.
310. If construction contracts do not contain provisions which are consistent with section 108(2) to (4) and section 110 (or, as regards section 109, the parties fail to agree upon the amounts or the frequency or circumstances of payments), the terms of the relevant Scheme for Construction Contracts apply – one Scheme in respect of contracts for construction operations carried out in England and Wales, and the other in respect of contracts for construction operations carried out in Scotland. Where either Scheme applies, such terms have effect as implied terms of the relevant contract – in effect supplying the missing contractual provision.
311. In addition, Part 2 of the 1996 Act allows a contractor to stop working where the payer owes the contractor money (section 112) and renders ineffective clauses in construction

contracts which make payments conditional on the payer having been paid by a third party (section 113). As originally enacted, section 111 of the 1996 Act required the giving of an appropriate notice by the payer where the payer proposed to withhold moneys (which notice could, if various conditions were met, be the same notice as that given by the payer of the sum which he proposed to pay).

## **Summary**

312. **Part 8** of the Act amends Part 2 of the 1996 Act. It is comprised of eight sections, a brief description of which follows:

- Section 138 substitutes a new power allowing the Secretary of State and Scottish and Welsh Ministers to disapply any or all of the provisions of Part 2.
- Section 139 removes the original limitation of Part 2 to contracts which were in writing;
- Section 140 introduces a provision to facilitate the correction of clerical or typographical errors in an adjudicator's decision;
- Section 141 makes an agreement about the allocation of the costs of adjudication ineffective, unless certain conditions apply;
- Section 142 addresses the issue of making periodic payments under a construction contract conditional upon obligations under another contract, and the issue of making the date a payment becomes due dependent upon the giving of a notice by the payer of the sum the payer proposes to pay;
- Section 143 amends the original provisions relating to the notices which a payer gives of the sum which the payer proposes to pay and introduces provisions relating to the giving of notices by the payee;
- Section 144 introduces (in most cases) a statutory requirement to pay sums specified in these notices;
- Section 145 amends the original provisions relating to a contractor's right to stop working when the contractor has not been paid.

## **Commentary on sections**

### ***Section 138 - Application of construction contracts legislation***

313. *Subsection (3)* of section 138 inserts new section 106A into the 1996 Act. New section 106A(1) allows the Secretary of State (as regards the law of England and Wales) to disapply, by order, any or all of the provisions of Part 2 in relation to descriptions of construction contract (not being ones for construction operations in Wales) specified in the relevant order. New section 106A(2) allows the Welsh Ministers (as regards the law of England and Wales) to disapply, by order, any or all of the provisions of Part 2 in relation to descriptions of construction contract (being ones for construction operations in Wales) specified in the relevant order. New section 106A(3) allows the Scottish Ministers (as regards Scots law) to disapply, by order, any or all of the provisions of Part 2 as regards descriptions of construction contract specified in the relevant order. This new power replaces the power in Part 2 as it was originally enacted which allowed the disapplication of the whole of Part 2 (but which did not allow the disapplication of only parts of Part 2).

### ***Section 139 - Requirement for construction contracts to be in writing***

314. As originally enacted, section 107 of the 1996 Act provided that Part 2 of the 1996 Act only applied to contracts which were "in writing". This was interpreted restrictively by the courts such that all of the non-trivial terms of construction contracts had to be

*These notes refer to the Local Democracy, Economic Development and Construction Act 2009 (c.20) which received Royal Assent on 12 November 2009*

“in writing” for Part 2 to apply. Section 139 removes this general requirement, whilst prescribing that various matters must nonetheless be in writing.

315. *Subsection (1)* repeals section 107 in its entirety with the effect that Part 2 of the 1996 Act will apply to all construction contracts – those which are wholly in writing, partly in writing or wholly oral.
316. *Subsection (2)* provides that certain provisions of a construction contract, relating to adjudication, must be “in writing”. These are various provisions relating to adjudication.

#### ***Section 140 - Adjudicator’s power to make corrections***

317. This section inserts new subsection (3A) into section 108 of the 1996 Act. New subsection (3A) has the effect of requiring the parties to a construction contract to provide in their contract that the adjudicator has the power to correct a clerical or typographical error in his decision arising by accident or omission. The provision concerned must be in writing. Such a requirement of their contract is in addition to the requirements which already apply.

#### ***Section 141 - Adjudication costs***

318. **Section 141** inserts new section 108A into the 1996 Act. New section 108A provides that any contractual provision by the parties to a construction contract concerning the allocation between them of costs relating to an adjudication is ineffective except in two cases. The first such case is where the contractual provision is in writing, is a provision of the parties’ construction contract, and is one which allows the adjudicator to allocate his own fees and expenses between the parties. The second such case is where the contractual provision is in writing and is made after the giving of notice by one party to the other of the former’s intention to refer a dispute to adjudication.

#### ***Section 142 - Determination of payments due***

319. **Section 142** inserts new subsections into section 110 of the 1996 Act. Subsection (1) of section 110 stipulates that every construction contract is to provide an “adequate mechanism” for determining what and when payments become due under the contract, and, in interpreting subsection (1), the courts have held that an “adequate mechanism” can include a certificate issued by a third party (for example, an architect or quantity surveyor) under a superior contract. This has caused difficulties – a sub-contractor may not be aware that a certificate has been issued in a superior contract and, where such a certificate covers work undertaken by other sub-contractors, payment to the sub-contractor is often delayed until all of the other work has been completed.
320. New subsection (1A) secures that it is not an adequate mechanism for these purposes to make the determination of what payments are due, or when, dependent upon the performance of obligations in a different contract (for example, in a superior contract) or upon someone’s decision as to whether obligations have been performed in a different contract.
321. New subsection (1B) has the effect of excluding, from this general prohibition at new subsection (1A), obligations (in a different contract) to make payments: section 113 of the 1996 Act already secures that “pay when paid” clauses in a construction contract (clauses whereby one party is not to be paid unless the other party has been paid) are (for the most part) ineffective.
322. New subsection (1C) creates a material exception to the general prohibition at new subsection (1A) to ensure, for instance, that payments in a superior contract can of course continue to depend upon the work carried out in a sub-contract. Thus, where a construction contract is an agreement between two parties (A and B) to the effect that a third party (C) is to carry out construction operations (a contract of the type referred to at section 104(1)(b) of the 1996 Act), it will be permissible for A and B to provide

in their contract that payments in that contract may be dependent upon C carrying out those obligations (in the contract which B has with C).

323. As originally enacted, section 110(2) of the 1996 Act provided that the parties to a construction contract had to include terms in their contract to the effect that, in relation to each payment and at most five days after such payment became payable (or would have become payable), the payer was to give the contractor (the payee) a notice. The notice had to specify the amount (if any) which the payer proposed to pay (or had by that time paid) and the basis on which that sum had been arrived at. New section 110A (see below) amends the original legislation relating to “payment notices”. New section 110(1D) provides that the giving of a “payment notice” to the contractor is not an “adequate mechanism” for determining *when* payments become due under the contract. New subsection (1D) therefore secures that a provision in the parties’ contract whereby a payment will only fall due if a “payment notice” in respect of that payment is given to the contractor is ineffective.

### ***Section 143 - Notices relating to payment***

324. **Section 143** amends the original legislation relating to “payment notices” and, in doing so, provides for the giving of similar notices by the contractor (the payee). Section 143 achieves this by repealing what was section 110(2) (*subsection (2)* of section 143) and inserting new sections 110A and 110B into Part 2 of the 1996 Act (*subsection (3)* of section 143).
325. New section 110A(1) provides that a construction contract is to contain either:
- a provision which, in relation to every payment, requires the payer (or a “specified person”) to give the payee a “payment notice”; or
  - a provision requiring the payee to give the payer (or a “specified person”) a “payment notice”;
- and in either case, requires the notice is to be given at most five days after the payment in question becomes payable.
326. A “specified person” is defined at new section 110A(6) – such a person is one identified in the construction contract or one “determined in accordance with” terms in the contract (for instance, terms allowing the payer subsequently to notify the payee of the appointment and identity of such person). In practice, a “specified person” is generally an architect or engineer: someone qualified to value construction work.
327. New section 110A(2) prescribes the contents of a “payment notice” given by the payer (or a “specified person”) to the payee. Such a notice is to identify the sum which the payer (or the “specified person”) believes is payable (by the payer) on the date that the payment concerned becomes payable (or, where some or all of that amount has been paid before the notice is given, the sum that would have been payable on such date). Such a notice is also to explain how that sum has been arrived at - for instance, by identifying any relevant moneys paid before the payment concerned actually became payable, or by identifying any set-off or abatement applied by the payer.
328. New section 110A(3) prescribes the contents of a “payment notice” given by the payee to the payer (or to a “specified person”). Such a notice is to identify the sum which the payee believes is payable (to the payee) on the date that the payment concerned becomes payable (or, where some or all of that amount has been paid before the notice is given, the sum that would have been payable on such date). Such a notice is also to explain how that sum has been arrived at.
329. The effect of new section 110A(4) is to ensure that, even where, in relation to any payment, the payer or, as appropriate, the payee, considers that no sum is actually payable, a “payment notice” to that effect must still be given. Such a notice is also to

explain (for instance, because of any set-off or abatement) why no sum is believed to be payable.

330. New section 110A(5) provides that where the parties to a construction contract fail to include terms in their contract for the giving of a “payment notice” pursuant to new section 110A(1), the appropriate provisions of the relevant Scheme for Construction Contracts will apply. (The consequence of this is that terms providing for the giving of a “payment notice” by the payer to the payee will take effect as implied terms of their contract.)
331. In addition to the definition of “specified person”, new section 110A(6) defines what is meant by “payee”, “payer” and “payment due date”.
332. New section 110B applies in a case where the parties to a construction contract have said in their contract that the payer (or a “specified person”) is to give the payee a “payment notice” (at most five days after payments become due) and, in relation to a particular payment, no notice is actually given (or, if given, is late). New section 110B also applies in a case where the parties have failed to make provision in their contract for the giving of “payment notices” (such that the relevant Scheme for Construction Contracts has implied a payer “payment notice” term into the contract), and, in relation to a particular payment, no notice is actually given (or, if given, is late). In other words, new section 110B addresses the situation of a payer failing to serve a payment notice as required either by an express or by an implied term of the contract.
333. The effect of subsection (2) of new section 110B is (generally speaking) to allow the payee to give the payer a “payment notice” instead (one which complies with the requirements (as to content) of a “payment notice” given by a payee in cases where parties to a construction contract have agreed in their contract that it is the payee who gives this notice). A notice like this given by a payee in default of a payer’s (or “specified person’s”) “payment notice” may be given at any time after the date by which the payer (or “specified person”) ought to have given the “payment notice”.
334. New section 110B(3) is a provision to postpone the “final date for payment” of a relevant sum where, pursuant to new section 110B(2), the payee serves a notice in default of the payer (or “specified person”) giving a “payment notice”. The effect of this new provision is to postpone the final date for payment of the sum in question by the same number of days after the date by which the payer (or “specified person”) ought to have given the “payment notice”, as the number of days after that date that the default notice was given. If, for example, a sum becomes payable on the 2<sup>nd</sup> day of the month (such that the date by which the “payment notice” should have been given was the 7<sup>th</sup> day) and must be paid, at the latest, on the 17<sup>th</sup> day, the effect of a payee’s notice in default served on the 14<sup>th</sup> day would be to postpone the date on which the relevant sum must finally be paid to the 24<sup>th</sup> day of the month (17 + 7 = 24).
335. Subsection (4) of new section 110B provides that where the parties had agreed in their contract that the payee was to notify the payer (or a “specified person”) of the sum that the payee believed was due in relation to a payment and of how that sum was arrived at (what in the construction sector is known as a payee’s “application”), such a notification is deemed to be a notice given pursuant to new section 110B(2) and, indeed, the payee cannot give a notice pursuant to new section 110B(2) in such a case.
336. *Subsection (1)* of section 143 makes a consequential amendment to bring the wording of section 109(4) into line with that used in new sections 110A and 110B.

#### ***Section 144 - Requirement to pay notified sum***

337. As originally enacted, section 111 of the 1996 Act provided that a party to a construction contract could not withhold payment after the “final date for payment” of a sum due under the contract unless that party had given a notice of the intention to do so. *Subsection (1)* of section 144 substitutes a new section 111 and, in doing so, replaces this

provision in respect of “withholding notices” with (generally speaking) a requirement on the part of the payer to pay the sum set out in such a notice. New section 111 also makes provision for the sum in such a notice to, in effect, be challenged or revised by the giving of a type of counter-notice.

338. Subsection (1) of new section 111 provides that the payer must pay the “notified sum” — the sum set out in such notice — on or before the final date for payment of such sum, (to the extent that it is unpaid). Subsection (2) has the effect of explaining what is meant by “the notified sum”. In relation to a payment, it is (as appropriate):
- the sum set out in a “payment notice” given by a payer (whether such notice is given pursuant to an express term or one implied into the contract pursuant to the relevant Scheme for Construction Contracts) or by a “specified person” (subsection (2)(a));
  - the sum set out in a “payment notice” given by a payee (subsection (2)(b));
  - the sum set out in a payee’s “payment notice” in default of one given by the payer or “specified person” (subsection (2)(c)); or
  - the sum set out in a payee’s “application”, where such notification is deemed to be a notice given in default of one given by the payer (subsection (2)(c)).
339. This requirement to pay the notified sum is intended further to facilitate cash flow by determining what is provisionally payable. What is properly and ultimately payable as a matter of the parties' contract is unaffected (see the decision of the Court of Appeal in *Rupert Morgan Building Services (LLC) Limited v Jervis* [2003] EWCA Civ 1563) (a transcript of the judgement can be found at <http://www.bailii.org/ew/cases/EWCA/Civ/2003/1563.html>).
340. Subsection (3) of new section 111 provides that a payer (or a “specified person”) may, in relation to a payment, give a notice to the payee of the payer’s intention to pay less than the notified sum. Subsection (3) permits both the giving of such a counter-notice where the notice containing the “notified sum” was given by the payee and, also, the giving of such a counter-notice where the notice containing the “notified sum” was given by the payer – a payer may wish to revise the amount he proposes to pay because, for instance, he subsequently discovers that the work in question was unsound.
341. Subsection (4) prescribes the content of such a counter-notice. It must identify the sum which the payer believes is payable on the date that such notice is given and is to explain how that sum has been arrived at (for instance, by identifying any moneys already paid by the date of the notice or by identifying any set-off or abatement applied by the payer). Subsection (4) makes it clear that such counter-notice may be for a nil payment (for example, as a consequence of any such set-off or abatement).
342. Subsection (5), read in conjunction with subsection (7), prescribes the timing of such a counter-notice. It must be given no later than such number of days as the parties have agreed in their contract before the final date for payment or, where there is no contractual provision, such number of days before the final date for payment as the relevant Scheme for Construction Contracts provides. Subsection (5)(b) has the effect of prohibiting the giving of such a counter-notice before the payee has actually given his “payment notice” (whether in a case where the parties had agreed in their contract that “payment notices” were to be given by the payee, or the payee is giving (or is deemed to have given) his “payment notice” in a default of the payer giving a “payment notice”).
343. Subsection (6) has the effect that the amount set out in a counter-notice given under subsection (3) of new section 111 becomes the “notified sum” which the payer must pay pursuant to subsection (1).
344. Subsection (7) defines the “prescribed period”. It is the period that has been agreed by the parties to the construction contract. Where there is no such agreement, the provisions

of the relevant Scheme for Construction Contract will apply. The Schemes currently provide that this is seven days before payment is finally due.

345. Subsection (8) states that subsection (9) applies where the payment notice provisions have been complied with but there is a dispute about the amount owing and the adjudicator decides that more money is owed than that set out in the relevant notice.
346. In such a case, subsection (9) provides that any such additional amount must be paid by the date which is the later of seven days from the date of the adjudicator's decision or the date which, but for the notice, would have been the final date for payment.
347. Subsection (10) has reference to the decision of the House of Lords in *Melville Dundas Limited (in receivership) and others v George Wimpey UK Limited and others* [2007] UKHL 18 (a transcript of which judgment can be found at <http://www.bailii.org/uk/cases/UKHL/2007/18.html>). In that case, the House of Lords decided that the payer could legitimately withhold moneys, notwithstanding that no “withholding notice” under current section 111 of the 1996 Act had been given, in a case where the parties’ contract had provided that moneys need not be paid in the event of the payee’s insolvency. The key to that decision was the fact that the insolvency occurred *after* the period for giving a “withholding notice” had expired i.e. it was not in the nature of things possible for the payer to have given such a notice beforehand.
348. Subsection (10) is intended to ensure that the *Melville Dundas* decision remains confined to insolvency situations alone (and is not interpreted to include other events which the parties may have specified in their contract). In the context of new section 111, it provides that the subsection (1) requirement to pay the “notified sum” does not apply where the contract allows the payer to withhold moneys upon the payee’s insolvency and the payee becomes insolvent after the expiry of the period for giving a notice of intention to pay less than this sum (pursuant to subsection (3)).
349. Subsection (11) applies the existing definitions of “insolvent” in the 1996 Act (section 113) to subsection (10).
350. *Subsection (2)* of section 144 makes consequential amendments to section 112 of the 1996 Act such that, in effect, relevant references in that section are to the new subsection (1) requirement i.e. the requirement to pay the “notified sum”.

### ***Section 145 - Suspension of performance for non-payment***

351. Section 112 of the 1996 Act permits a contractor to stop carrying out work under the contract in the event of non-payment by the other party.
352. *Subsection (2)* of section 145 amends subsection (1) of section 112 to put it beyond doubt that a contractor may stop carrying out some, and not simply all, of the work in such a case.
353. *Subsection (3)* of section 145 inserts a new subsection (3A) into section 112. The effect of this is to make the “party in default” (the party who has not paid) liable to pay to the contractor stopping work pursuant to section 112 a reasonable amount by way of the costs and expenses he incurs by stopping work (for instance, the payee’s reasonable costs in redeploying staff or removing plant and equipment).
354. *Subsection (4)* of section 145 amends subsection (4) of section 112. Section 112(4) as originally enacted provided that any period during which the contractor stopped work in pursuance of this right to do so in a non-payment situation was to be disregarded in calculating any time period prescribed in the contract. The amendment extends this to any period in which the contractor stops work “in consequence of the exercise of” this right; with the effect that extra time is allowable – for instance, the time which the payee requires to remobilise staff or return plant and equipment to the relevant site.