A NEW REGIME IN CONSTRUCTION ADJUDICATION?
1 INTRODUCTION

The purpose of this paper is to review the changes that the Local Democracy, Economic Development and Construction Act (LDEDCA) 2009 (Parliament 2009) makes to the Housing Grants, Construction and Regeneration Act (HGCRA) 1996 (Parliament 1996). It includes commentary where these changes have an effect on adjudication practice.

In 2004, the government of the day took on board the fact that there was sufficient concern about the way in which the HGCRA was working to warrant a review. This was made public by the inclusion of the following passage in the Chancellor of the Exchequer’s Budget Report:

‘Following concerns raised by the construction industry about unreasonable delays in payment, the government will review the adjudication and payment provisions of the Housing Grants, Construction and Regeneration Act in order to identify what improvement can be made.’

Sir Michael Latham was then asked to review the legislation, and his findings (Latham 2004) were published in September 2004. In his report, he concluded that the HGCRA was generally working well but a few improvements would be beneficial if means could be found to deliver them without any adverse impacts on other parties or other elements of payment processes.
2 THE 2005 CONSULTATION

Following Sir Michael Latham’s report, a preliminary consultation paper, entitled ‘Improving Payment Practices in the Construction Industry’, was published in March 2005 (Department of Trade and Industry (DTI) and Welsh Assembly Government 2005). This paper sought views on the following:

• how to improve the ability of parties to a construction contract to reach agreement on what should be paid and when;

• how to improve the ability of parties to a construction contract to manage cash flow and enable completion of work on the project;

• how to reduce disincentives to referring disputes to adjudication.

One of the principal motivations behind these particular points was lobbying by organisations representing subcontractors concerned that their members were being disadvantaged, and in some cases deterred from starting an adjudication, by a provision included in contracts by many main contractors. This required them to pay not only the adjudicator’s fees but also the entirety of both parties’ costs of the proceedings, whatever the outcome of the adjudication. Interestingly, the way in which this difficulty has been addressed in the LDEDCA has caused rather more comment than all the other provisions together. This is discussed later in this paper.
3 THE SECOND (2007) CONSULTATION

After an analysis of the consultation responses was published in January 2006 (DTI and Welsh Assembly Government 2006) various discussions were held; the result of which was that a second consultation paper was issued in June 2007 (DTI and Welsh Assembly Government 2007). In this paper it was emphasised that the improvement in payment practices remained a priority, together with the need to respect the principle of freedom of contract by intervening only in those situations where it is deemed essential. In addition, the paper noted the continuing development of case law on adjudication and the payment provisions of the HGCRA. The following points emerged as proposed improvements to the adjudication process:

- removing the requirement that the HGCRA should only apply to contracts in writing;
- prohibiting agreements that interim or stage payment decisions will be conclusive;
- introducing a statutory framework for the costs of adjudication.

As far as payment was concerned, comments on the following were invited:

- prevention of unnecessary duplication of payment notices;
- clarification of the requirement that an s.110(2) payment notice should be served;
- clarity of the content of payment and withholding notices;
- ensuring the payment framework creates a clear interim entitlement to payment;
- prohibiting the use of pay-when-certified clauses;
- improving the statutory right to suspend performance by allowing the suspending party to claim the costs and delay that result.

The consultation also put forward questions on devolution and the introduction of a ‘slip’ rule. Comments on the implications of the House of Lords judgment in *Melville Dundas Limited v. George Wimpey UK Limited* [2007] were also invited.
3.1 THE RESULTS OF THE SECOND CONSULTATION

These were reported in July 2008 (Department for Business Enterprise and Regulatory Reform (BERR) and Welsh Assembly Government 2008).

There was overwhelming support for the proposal to remove the requirement that the HGCRA should only apply to written contracts. However, there was some concern that an unintended consequence of this proposal might be to increase adjudication costs and that it should not encourage parties to agree oral contracts. Consultees widely supported a proviso that any provisions relating to a contractual adjudication scheme would still need to be in writing.

There was strong support for amending the HGCRA to prohibit agreements that decisions regarding the amounts of payments (whether by instalment, stage or other periodic payments) were conclusive, although there was concern that it would limit the parties’ freedom to contract.

There was considerable support for the proposal to prohibit agreements on the allocation of the costs of the adjudication until after the adjudicator was appointed (this is the provision that seeks to address those clauses whereby one party pays all the costs of the adjudication come what may). There was also broad support for the adjudicator to be statutorily entitled to claim for his fees and expenses.

Making the parties jointly and severally liable for the adjudicator’s fees and expenses was also welcomed, and there was some support for the principle that the costs should lie where they fall.

The next intention of the proposed revisions was to improve the transparency and clarity in the exchange of information relating to payments to enable the parties to construction contracts to better manage cash flow. The consultation proposals were:

- prevention of unnecessary duplication of payment notices;
- clarification of the requirement that an s.110(2) payment notice should be served;
- clarity of the content of payment and withholding notices;
- clarity of the sum due;

with respect of the prevention of unnecessary duplication of payment notices, there was strong support for the proposal to allow a notice or certificate from a third party to act as an s.110(2) payment notice. There was concern that the proposed legislation should reflect language used in the industry rather than introducing amendments which were overly legalistic.
There were mixed reactions to s.110(2) payment notices. Appropriate terminology in the amended wording was considered important and it was pointed out that phrases such as ‘set-off’ and ‘abatement’ were not widely used in the industry and were confusing. A view was expressed that the s.10(2) payment notice should simply state what was to be paid and the grounds for paying that sum. There was also a concern that any proposal should not be seen as encouraging cross-contract set-off.

There was considerable support for the proposal to clarify the requirements for the content of payment and withholding notices and to provide a clearer link between the content of s.110(2) and s.111 notices.

There was also wide support from those responding to the proposal to clarify the sum due, and strong support for the prohibition of pay-when-certified clauses. The point was made that parties very rarely exercised their right to suspend performance and the proposal to improve the right to suspend performance was almost universally supported.

As far as devolution was concerned, the vast majority of respondents were in favour of cross-border uniformity with the devolved administrations. Over 90% of respondents were also in favour of the introduction of a ‘slip’ rule.

Many of the comments in respect of the House of Lords judgment in *Melville Dundas Limited v. George Wimpey UK Limited* [2007] were that the HGCRA should be amended to make it clear that, other than in cases of a subsequent insolvency, the requirement for the payer to issue an s.111 withholding notice should apply.

As with the original statutory requirements which were shoehorned into an ongoing Bill relating to housing grants and regeneration, the proposals from the 2007 consultation process had to be fitted into other proposed legislation, as there was insufficient parliamentary time or inclination to take them forward as a separate Bill. The chosen vehicle was a Bill that also dealt with local democracy and economic development and the LDEDCA became law in 2009. The implementation of Part 8 of this Act had to wait until consultations on related alterations to the Scheme for Construction Contracts were completed and the LDEDCA and the revised Scheme came into force on 1 October 2011. They apply to contracts entered into after that date.
4 THE PROVISIONS OF PART 8 OF THE LOCAL DEMOCRACY, ECONOMIC DEVELOPMENT AND CONSTRUCTION ACT 2009

This part comprises ss138–145:

- Sections 138 and 139 relate to the scope of the applicability of Part II of the HGCRA.
- Sections 140 and 141 relate to adjudication.
- Sections 142–144 relate to payment.
- Section 145 relates to the devolution of power to the Welsh Assembly and the Scottish Parliament and includes separate provisions for England, Wales and Scotland.
4.2 SECTION 139: REQUIREMENT FOR CONSTRUCTION CONTRACTS TO BE IN WRITING

While this amendment actually relates to the applicability of the whole of Part II of the HGCRA, it is a matter that specifically addresses a problem that has arisen with access to adjudication.

The restrictive interpretation placed on what, to the layman, appeared to be the wide provisions of s.107 HGCRA by the Court of Appeal in *RJT Consulting v. DM Engineering (RJT)* [2002] was somewhat of a surprise to many involved in the construction industry. The Court of Appeal’s reasoning may well have been logical from the lawyers’ point of view, but was seen by a large proportion of the construction industry as placing a considerable barrier in the way of a large proportion of the industry that does not dot every ‘i’ and cross every ‘t’ when recording their agreement.

The opportunity was taken in the review of the HGCRA to consider getting around the decision in *RJT* and reverting to a position more akin to that which much of the construction industry expected to apply.

As noted above, there was some concern that this would encourage increases in the cost of adjudication and a departure from the ideal of certainty as to contractual arrangements. This latter point mainly came from those parts of the construction industry, such as the major contractors, who were not generally those suffering from the restriction on access to adjudication caused by the decision in *RJT*. However, in the context of the declared aim of the review to improve payment practices, the pleas of the subcontractors who were the principal sufferers of the effects of the decision in *RJT* held sway and s.107 HGCRA has been repealed.

The main concern expressed by one legal commentator relates to the development of a dispute regarding arguments as to whether or not an important contractual term was ever agreed, into one that relates to whether or not there was ever any intention to create legal relations; the anticipated result of which would be that there was no construction contract at all and after lengthy argument and considerable cost the adjudication would prove a nullity. That may well be something that will trouble the courts in due course when enforcement is being considered. However, as far as the adjudicator is concerned, they will, within the limited time available, have to deal with the parties’ arguments regarding what was or was not agreed and apply the terms as they find them. It is only if the adjudicator is convinced that there is no agreement at all that they will resign, and that is of course a matter for the evidence put before them.
Of greater concern, perhaps, are the suggestions that the cost of adjudication will be substantially increased if adjudicators have to determine what oral terms apply as a result of this change. In reality, to date, many disputes as to whether a contract is in writing have related to those where relatively few of the contractual terms required by the judgment in *RJT* are lacking. In such a case, determination of what actually applies, particularly with the Scheme for Construction Contracts in the background to fill in any gaps, should not add much in terms of time and cost.

It is, however, where the allegation made relates to the existence of a wholly, or almost wholly, oral contract that things may be rather more difficult. As it is likely that an adjudicator will have to hold a hearing to determine what was agreed orally, there will be considerable pressure on them if they have to deal with the oral evidence regarding the agreement and then deal with all the substantive issues within what may be no more than 28 days. Only time will tell how this will pan out, but a practical solution may be to have a first adjudication to sort out what terms the parties have agreed before dealing with the substantive issues.

The only specific requirement as to anything being in writing now included relates to the adjudication agreement, but of course this will only apply if the parties wish an adjudication to be conducted other than under the Scheme.

### 4.3 SECTION 140: ADJUDICATOR’S POWER TO MAKE CORRECTIONS

The power of the adjudicator to correct errors has been adequately addressed by the courts in the case of *Bloor Construction (UK) Limited v. Bowmer & Kirkland (London) Limited* [2000] and since then has never been in doubt, so some surprise has been expressed at the inclusion of s.140 in the LDEDCA. However, there does appear to have been some doubt on the part of some parties and perhaps some adjudicators as to what they can do should a mistake become evident in a decision.

Section 140 puts beyond peradventure the adjudicator’s right, and some might say obligation, to correct a clerical or typographical error arising by accident or omission. It requires the inclusion of such a provision in the contract, failing which the Scheme (as amended in 2011) fills the gap.

Interestingly, this requirement fails to provide a time for such corrections to be made, whereas the revised Scheme provides that any correction must be made within five days of delivery of the decision. This suggests that if the parties include a clause in their contract that complies with the LDEDCA (and which excludes any time for correction to be made) errors identified outside the five-day period may be corrected. Of course, it would not be wrong for parties to amplify this requirement by inserting a period for correction, be it five days or a longer or shorter period.
There is an argument that limiting what can be corrected means that an adjudicator is prevented from correcting a patent error in the decision, and there is thus, as a result, a danger that the dispute will be prolonged rather than settled by the adjudication. However, the pragmatic adjudicator who is interested in resolving disputes rather than prolonging them will no doubt come clean if there is such an error and inform the parties accordingly.

4.4 SECTION 141: ADJUDICATION COSTS
One of the main concerns expressed in the submissions by the subcontractors’ organisations to the government during the extended consultation period was a desire to remove the heavy yoke of the Tolent clause, whereby one party (generally the subcontractor) is forced to pay all the costs of the adjudication (that is, both parties’ costs incurred in the adjudication process) plus the adjudicator’s fees and expenses, irrespective of who initiated the process and the outcome. Section 141 is the result.

It is worth setting out the exact words that are included in s.141, as these have produced a substantial debate – so much so that it was even suggested that s.141 should not be brought into force with the remainder of Part 8 of the LDEDCA.

‘108A Adjudication costs: effectiveness of provision

1. This section applies in relation to any contractual provision made between the parties to a construction contract which concerns the allocation as between those parties of costs relating to the adjudication of a dispute arising under the construction contract.

2. The contractual provision referred to in subsection (1) is ineffective unless –

   (a) it is made in writing, is contained in the construction contract and confers power on the adjudicator to allocate his fees and expenses as between the parties, or

   (a) it is made in writing after the giving of notice of intention to refer the dispute to adjudication.’

The intention of this provision has been made quite clear in the parliamentary debates on the matter – it is to outlaw any contractual provision that tends to prevent a party from taking a dispute to adjudication by making it liable for more than its own costs and, if so decided, the adjudicator’s fees and expenses, except in the two specific circumstances identified in s.108A(2).

It was decided that the parties should not be prevented from reaching such an agreement after an adjudication has commenced, and Subsection (2)(b) is the result.
There is a problem relating to the wording of Subsection (2)(a) – specifically, that the words: ‘is made in writing, is contained in the construction contract and confers power on the adjudicator to allocate his fees and expenses as between the parties’ do not mean what Parliament intended. It is suggested that they can be interpreted as saying that as long as the clause includes a provision conferring power on the adjudicator to allocate their fees and expenses, it can also say that one party pays the whole costs of the process come what may and still not fall foul of the legislation.

This point was made pretty strongly to officers at the Department for Business Innovation & Skills (BIS) who, having consulted with their in-house lawyers, stated that the words did make unlawful any contractual provision that made any wider interpretation than that it is solely the adjudicator’s fees and expenses which are covered.

There is some heavyweight support from the Supreme Court in the case of *Bloomsbury International Limited v. Sea Fish Industry Authority* [2011] for the view that words in a statute should not be submitted to a narrow textual analysis and that the statutory purpose of the legislation is of central importance.

It is, however, by no means certain that those sectors of the industry that use their commercial clout to include *Tolent* clauses in their contracts will cease to do so, and it is almost certain that the matter will have to come before the courts in due course.
4.5 SECTION 142: DETERMINATION OF PAYMENTS DUE

Section 110 HGCRA specifically banned ‘pay-when-paid’ clauses. What it did not do was to address what are called ‘pay-when-certified’ provisions. A problem has been perceived in the interpretation by the courts of s.110 to the effect that certification by an architect or quantity surveyor under a superior contract fulfils the requirement for an adequate mechanism for payment.

Section 142(2) addresses the problem of payment relying on anything that may have to be done under another contract in two ways:

• firstly, in s.110 HGCRA, Subsection (1A)(a) is inserted, which confirms that the requirement for an adequate mechanism for payment is not fulfilled where a construction contract makes payment conditional upon the performance of obligations under another contract – an example of this would be making payment to a subcontractor reliant on the contractor carrying out any obligations that it may have under the main contract;

• secondly, the addition of Subsection (1A)(b) to s.110 confirms that payment may not be made conditional upon a decision by any person as to whether obligations under another contract have been performed – this directly addresses the point regarding certification under a superior contract.

The draft Bill that was published shortly after completion of the 2007 consultation went no further than making these two amendments, but in the development of the LDEDCA certain exclusions from these general provisions were considered necessary and further Subsections (1B), (1C) and (1D) were added. By Subsection (1B) obligations under another contract relating to the making of payments are excluded from this general prohibition. Subsection (1C) confirms that (1A) does not apply where the contract in question is an agreement between the parties for the carrying out of construction operations by another person, thus making it permissible for the parties to a main contract to provide that payment may be dependent upon the completion of work by a subcontractor. Subsection (1D) makes ineffective a contractual provision whereby the date for payment is determined by reference to the giving of a notice by the payer to the payee. Thus, a contract clause that bases the date for payment on the date that the main contractor gives notice of that payment to a subcontractor is ineffective.
4.6 SECTION 143: NOTICES RELATING TO PAYMENT

This section replaces the ineffective ‘110 notice’ provision in the HGCRA with a more robust regime. The HGCRA contains no sanction against the payer who does not provide the payee with the notice required by s.110 of the amount that it proposes to pay. Experience has shown that where a payer fails to provide the requisite notice and does not pay, there is no fall-back procedure. Subcontractors in particular have perceived a difficulty in obtaining payment, particularly on an interim basis and, in the absence of a clearly identified sum due, consider that they have little upon which to base a notice of adjudication.

The result has been a considerable overhaul of s.110 by the addition of s.110A

‘Payment notices: contractual requirements’ and s.110B ‘Payment notices: payee’s notice in default of payer’s notice’.

Section 110A widens the requirements regarding the giving of notices from that in the original HGCRA. It retains the requirement that a contract provides for a ‘payment notice’ to be given not later than five days after the payment due date. It does, however, now allow alternative provisions within a compliant contract. The contract can thus provide for the notice to be given to the payee by the payer, as previously, but it can now, as an alternative, provide for the notice to be given by a specified person on the payer’s behalf to the payee. As a further alternative, a contract can allow the payee to give the notice to the payer (or to a specified person). The section also defines what the content of the notices must be and requires a contractual provision that even if no sum is considered payable a notice is still given. There is the customary provision relating to the applicability of the Scheme if the contract does not comply with the specified requirements, and there are definitions of ‘specified person’, ‘payee’, ‘payer’ and ‘payment due date’.

Section 110B is the major change and addresses the problems that arise when a payment notice is not given by the payer under the unamended HGCRA provisions. A payee under a contract that requires the giving of a payment notice by the payer, or a specified person, now has statutory power under s.110B(2) to remedy any default by issuing its own payment notice, which then stands in place of the non-existent payer’s notice. In such an event, s.110B(3) postpones the final date for payment by the same number of days as the period between the date that the payer should have issued its notice and the date that the payee issues its own payment notice. Section 110B(4) provides for the situation where the parties agree in their contract that the payee is to provide notification of the sum that the payee believes to be due, and makes this ‘payee’s application’ the notice provided for in s.110B(2). In such a contract, the payee has no right to issue a further notice as provided for in s.110B(2).
4.7 SECTION 144: REQUIREMENT TO PAY NOTIFIED SUM
The whole of the original s.111 has been replaced by a lengthy new provision. This requires, in Subsection 1, the payment of the previously notified sum on or before the final date for payment. Subsection 2 cross-references back to s.110A(2) and defines the ‘notified sum’. Subsection 3 replaces the old ‘withholding notice’ with what is now described as a notice of the payer's intention to pay less than the notified sum or, in short, a ‘pay less notice’ and Subsection 4 states the requirements for a pay less notice to be valid. The rest of the section relates principally to timing and other procedural matters including confirmation that the requirement to pay a notified sum does not apply where the payee becomes insolvent.

4.8 SECTION 145: SUSPENSION OF PERFORMANCE FOR NON-PAYMENT
This section amends s.112 HGCRA to confirm that a contractor may suspend some and not simply all of its work, thus confirming that where there is, for instance, an obligation to maintain scaffolding, this can continue. This section also provides that the party suspending performance is entitled to recover a reasonable amount of the costs and expenses incurred by reason of stopping work and that there is an entitlement to an extension time for remobilisation.
REFERENCES


RJT Consulting Engineers Ltd v. DM Engineering (NI) Ltd [2002] EWCA Civ 270.
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