



Welcome to the September 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 Payment under the New Construction Act & Revised Scheme.

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Payment under the New Construction Act & Revised Scheme

3 October 2011 marks the first working day of the operation of 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") in England and Wales.*

This note provides pointers on how the New Act and Revised Scheme are likely to operate in practice. For full details of the payment procedure under the New Act and Revised Scheme please see the second issue of *Insight*.

*The effective date for Scotland is 1 November 2011.

Practicalities

Who serves the payment notice?

The New Act alters the previous regime whereby only the payer could serve a payment notice. The contract must now dictate by whom the payment notice should be served and this can be either the payer, a specified person (for example, the architect or contract administrator) or the payee.

If (as is the position under most standard forms) the contract provides for payment applications to be made and the payee has issued an application that complies with the requirements of a payment notice, the compliant application will stand as the payment notice.

If the contract is silent on service of the payment notice, the payer must serve the payment notice under the Revised Scheme.

I have received a 'nil' payment notice. Is this permitted?

Yes. A payment notice must be served on all contractual due dates even if the sum due is zero. Zero payment notices will probably most commonly be seen during the defects liability period.

What happens if I am the payee and no payment notice is served by the payer?

It is open to the payee to serve a default payment notice provided no payment application or payment notice has already been issued by the payee. Service of a default payment notice should be effected immediately following non-service of a payment notice. This is to prevent the final date for payment being extended by the number of days between the date upon which the payment notice should have been served and date of service of the default notice. If service is delayed, this will prolong the payment periods under the contract.

A payless notice has just been served – what now?

Payless notices substitute the old withholding notices and their validity

can be challenged if they do not state (i) the sum the payer considers to be due on the date the payless notice is served and (ii) the basis on which that sum is calculated.

Exactly what a payless notice should include will no doubt occupy the Technology and Construction Court before too long, but until the requirements are clarified, at the highest, a payless notice would have to present the sum due in the form of a breakdown and include any ground(s) for withholding with reference to the alleged contractual breaches and the factual matrix. If this level of detail does not appear, then an argument might be available to the payee that the payless notice is invalid in which event the sum notified by the payment application, payment notice or default notice (as the case may be) would become due at the final date for payment. The consequences of a failure to serve a valid payless notice are such that payless notices (and indeed all other types of payment notice) should include much more detail than has been the case historically.

What happens if (i) a payless notice is not served (ii) a payless notice is served but is invalid or (iii) payment is not made?

If any of the above apply, or if any requisite timescales are not met, the payee is now entitled to suspend performance of all or part of its obligations under the contract upon (i) service of a payment application / payment notice or default payment notice (as the case may be) and (ii) the provision of seven days' written notice which notice should include the ground(s) for suspension. If payment is later made in full, the payee must immediately resume all work as the entitlement to suspend will cease to exist.

Provided the suspension is valid, the payee can claim (i) the direct costs and expenses reasonably incurred as a result of the suspension (for example, de-mobilisation, costs incurred during the period of suspension and re-mobilisation costs) and (ii) an extension of time for the delay caused in consequence of the suspension.



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Any claim under (i) will not include legal fees or any loss of profit as such losses would be regarded as consequential unless express contractual provision was made for their recovery in the event of a valid suspension.

Suspension rights for non-payment will be more frequently invoked as a tactical alternative to adjudication; even the threat to suspend might now result in payment, particularly if the threatened suspension relates to an item of work important to the payer, or a commissioning obligation in circumstances where the works are otherwise almost complete. In order to counter payees' improved suspension rights, it is likely that payers will seek to increase the period of notice prior to any suspension to allow more time for disputed payment items to be discussed and possibly negotiated.

The payment provisions in my contract are linked to payment under another contract. Is this allowed?

No. 'Pay when certified' clauses (i.e. clauses whereby a sub-contractor is unable to obtain payment until sums are certified under the main contract to which he is not party) are now illegal. Four separate issues arise:

(1) the main contractor can no longer agree his sub-contractor is only paid when he receives payment under the main contract;

(2) payment can no longer be made conditional upon a decision by any person as to whether obligations under another contract have been properly performed;

(3) the payment due date can not be determined by reference to a notice given to the payee; and
(4) release of the retention can no

longer be triggered by an event occurring pursuant to an upstream contract, for example, a sub-contract which relies on Practical Completion under a main contract to trigger release of the first moiety of retention.

In order to prevent cash flow problems from arising, main contractors might now seek to increase sub-contract payment periods during contract negotiations to avoid finding themselves in a situation whereby they are obliged to make payment to sub-contractors when they are not themselves in funds.

What about management contracting and PFI contracts – are they any different?

Yes. There are two possible exceptions to the ban on 'pay when certified' and only time will tell whether they will operate as effective exclusions.

The first is where a construction contract is an agreement between two parties which requires a third party to carry out the construction operations (for example, a management contract). In this situation, parties will be able to agree that payments are conditional upon the third party carrying out its obligations.

The second is first-tier PFI sub-contracts where the contractor only becomes entitled to payment by the project company once it has become entitled to such payment under the project agreement. Lower-tier sub-contracts entered into by the first-tier design and build sub-contractor or operating sub-contractor will however probably still be caught by the prohibition on 'pay when certified' clauses.

I am a payee and I have become insolvent. What happens now?

Everything depends on when the insolvency event occurred and what the contract says.

If the contract provides for

withholding in the event of insolvency and insolvency occurs after the date on which a payless notice is due to be served (regardless of actual service of the payless notice) and prior to the final date for payment, then payment will not have to be made. Where a payee goes insolvent shortly prior to a payless notice falling due, the payer will have to make payment regardless.

This is because the preceding payment application / payment notice or default payment notice (as the case may be) will stand as the notified sum and will trigger the obligation to make payment. Any contractual clause that states otherwise will be ineffective.

Conclusion

From now on, all new contracts will have to comply with the New Act and (through default) the Revised Scheme and amendments to existing contracts and project documentation will invariably be required. Standard terms that are already in place that apply to construction works will need to change and be amended to be brought into line with the new payment procedures under and the terminology of the New Act. Where work is sublet, any bespoke sub-contracts and professional appointments will have to be amended to expressly reflect the provisions of the New Act.

Changes will also be needed on the ground. Those who deal with payments under construction contracts will have to become fully familiar with the changes and the new regime and the potential consequences of a failure to issue timely notices, or risk being 'caught in the Act'.

Should you wish to receive further information in relation to this briefing note or the source material referred to, then please contact Lisa Kingston. lkingston@fenwickelliott.com. Tel +44 (0) 207 421 1986

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