



## **The New Construction Act**

**Briefing Note by Justin Mendelle, Partner**

### **Introduction**

The new Construction Act (or, to give it its full title, the Local Democracy, Economic Development and Construction Act 2009) came into force on 1st October 2011. The Act makes a number of important changes to the rules regarding adjudication, payment and suspension as enacted under the original Construction Act<sup>1</sup>.

The Act applies to all construction contracts that are entered into after 1st October 2011. If a contract does not provide for payments and adjudication as required by the Act, then by default, mandatory compliant terms will be implied into that contract.

### **Key Changes**

#### **1. Adjudication**

##### **1.1 Adjudication extended to Oral Contracts**

The Act abolishes the requirement for a construction contract to be wholly in writing i.e. parties that only have an oral contract or a contract that is partly written and partly oral will now be entitled to adjudicate a dispute. This is likely to lead to a significant increase in the number of adjudications, as it widens the scope of contracts that can now be referred to this form of dispute resolution. However, the Act does require the construction contract (whether written, oral, or partly oral) to incorporate “provision in writing” enabling the parties to refer a dispute to adjudication.

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<sup>1</sup> The Housing Grants, Construction and Regeneration Act 1996.



## 1.2 Adjudication costs

The new Act seeks to outlaw so-called Tolent<sup>2</sup> clauses i.e. clauses that require the party who refers the dispute to adjudication to be responsible for all of the costs of that adjudication (including the other side's costs and the fees of the adjudicator). There is debate within the legal community about whether the new Act in fact achieves this aim, which means that we await case law to hopefully provide clarity on the effect of the Act.

## 2. Payment

### 2.1 Notices

Under the new Act, all construction contracts must make provision for a payment notice to be given by the payer (the employer), a "specified person" (e.g. contract administrator) or the payee (the contractor/consultant). The notice must set out the sum due and how it has been calculated. It must be given not later than five days after the payment due date. A payment notice must be issued, even if the amount to be paid is zero. The amount in the payment notice then becomes the sum due.

Whilst there were similar obligations under the original Construction Act, they were largely ignored because there was no consequence for the payer if such a notice was not issued. No longer. Now, if the payer or specified person does not provide a payment notice when it is required to do so, then the payee may issue their own payment notice.

Once payment has been triggered by a notice, the payer or specified person may give notice that they will pay less than the specified sum stated in the notice, together with reasons for the reduced payment (this is known as a pay less notice). Again, even if the payment will be zero, a pay less notice must be issued which makes this clear. If a pay less notice is not provided, then the original sum must be paid without any deduction. Failure to make such payment will leave the payer with no effective defence against a claim from the payee.

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<sup>2</sup> The clause appeared in the case of *Bridgeway Construction Ltd v Tolent Construction Ltd*.



## 2.2 Pay when certified

Under the new Act, “pay when certified” clauses will no longer be an adequate mechanism for establishing what and when payments become due. This ban is however subject to a very important Exclusion Order, which makes it clear that the ban does not apply to so-called “first-tier” PFI contracts (e.g. the operating and design and build contracts that sit beneath the project agreement). This means that clauses which make payments in these first tier contracts conditional on performance under the project agreement will be allowed.

“Pay when paid” clauses were banned under the original Construction Act, save in respect of an “up-stream insolvency” (e.g. an employer going insolvent, which prevented a main contractor being able to pay a sub-contractor). Such clauses remain outlawed under the new Act.

## 2.3 Payments in the case of insolvency

The new Act enshrines the principle laid down in the House of Lords case of *Melville Dundas Ltd v George Wimpey UK Ltd*. This means that the payer does not have to pay the amount in the pay less notice if: (i) the payee becomes insolvent after the expiry of the time for giving the pay less notice but before the final date for payment and (ii) the contract allows for withholding of sums due in cases of insolvency.

## 3. Suspension

The new Act expands a payee’s right to suspend performance for non-payment. First, it now allows the payee to suspend performance of all or any of its obligations under the contract. Previously, obligations could not be suspended in part, meaning that the exercise of this right effectively meant having to stop work altogether. Secondly, the payee can recover its reasonable costs in exercising its suspension rights. Thirdly, once payment has been made and the payee resumes performance of his obligations, it is also entitled to the additional time taken to re-mobilise following the suspension. These provisions all strengthen the payee’s rights if it does not receive payment.



## Summary

The new Construction Act introduces important and practical changes to all construction contracts and will have an immediate impact on all such contracts entered into after 1 October 2011. Employers will need to be aware of the enhanced rights that their contractors and consultants now enjoy in order to ensure that they do not find themselves out of pocket or in front of an adjudicator.

This note does not provide specified legal advice and should not be acted or relied upon as doing so. If you would like further information or specific advice, please contact Justin Mendelle (0207 405 4600 or [jmendelle@sharpepritchard.co.uk](mailto:jmendelle@sharpepritchard.co.uk))