

## REPORT ON THE RESPONSES

to

### *‘IMPROVING PAYMENT PRACTICES IN THE CONSTRUCTION INDUSTRY IN NORTHERN IRELAND’*

Consultation on proposals to amend the Construction  
Contracts Order (Northern Ireland) 1997

and

The Scheme of Construction Contracts in Northern  
Ireland Regulations (Northern Ireland) 1999

November 2009



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## **EXECUTIVE SUMMARY**

The Department of Finance and Personnel's consultation paper "*Improving Payment Practices in the Construction Industry in Northern Ireland: March 2009*" put forward the following proposals:

### **Adjudication**

- Removing the requirement for contracts to be in writing for the Construction Contracts Order to apply;
- Prohibiting agreements that interim or stage payments decisions will be conclusive; and
- Introducing a statutory framework for the costs of adjudication.

### **Payment Framework**

- Preventing the unnecessary duplication of payment notices;
- Clarifying when a payment notice should be served;
- Clarifying the content of payment and withholding notices;
- Clarifying what constitutes the sum due; and
- Prohibiting pay-when-certified clauses.

### **Suspension**

- Improving the right of suspension.

### **Other Issues**

The consultation also posed questions on:

- Parity of legislation within the UK;
- The introduction of a 'slip rule' (allowing adjudicators to correct obvious errors in their decisions); and
- The implications of the House of Lords judgement in *Melville Dundas v George Wimpey*.

The response to the consultation exercise was modest with just seven replies being received. Of these, only four respondents actually completed DFP's questionnaire and one other, while not returning DFP's questionnaire, offered instead a copy of its original response to the very similar consultation in GB in June 2007. The remaining two respondents offered comments on DFP's proposals with statements of their respective organisations' viewpoints.

Generally, DFP's proposals were welcomed and essentially supported, although some differing and sometimes strongly held views were expressed. The divergence of opinion offered in some of the responses on specific points serves to underline the continuing need to deliver a balanced outcome to

reflect the complexity, diversity and the range of commercial interests represented within the construction industry.

The relatively small number of questionnaires returned may possibly reflect a perception that the issues are effectively being debated and resolved on a national basis. The limited response effectively precludes the practicality of any meaningful statistical analysis and this report has therefore sought to emphasise the qualitative rather than any quantitative aspects of the responses.

The responses to the proposals are summarised below:

### **On Adjudication**

- Respondents were unanimous that the Construction Contracts Order should be amended to remove the requirement that the Order should apply only to contracts in writing.
- All respondents broadly welcomed the prohibition of agreements where decisions as to the amounts of interim payments are conclusive.
- There was broad, but not unanimous, support for DFP's proposal to prohibit agreements on the allocation of costs of adjudication until after the adjudicator is appointed.

### **On Payment**

- Respondents agreed unanimously that that the Construction Contracts Order should be amended so that a certificate from a third party setting out a valuation of the work done may function as an Article 9 (2) payment notice and that an Article 9(2) notice may be issued by either the payer or a person identified in the contract.
- While most agreed with DFP's proposal to include provision in Article 9 (2) for greater clarity on when it is necessary to issue an Article 9 (2) payment notice, one respondent felt that guidance would be preferable to legislation.
- Broad support was offered for DFP's proposal to amend Article 9 (2) to require that in addition to the amount of a payment and the basis of its calculation, payment notices should state the amount of any sums withheld.
- All respondents accepted DFP's proposals that the Construction Contracts Order should be amended to ensure that both payer and payee should know the sum due for the purpose of Article 10 so that deductions can only be made by issuing a withholding notice and that, for the purpose of Article 11, both should know the amount to be paid if the payer is to avoid the possibility that the payee will suspend performance.

- All respondents agreed that pay-when-certified agreements should be prohibited.

### **On Suspension**

- The proposal to improve the right to suspend performance was agreed unanimously.

### **On Other Issues**

- All respondents agreed, some emphatically, that parity of legislation within the UK was highly desirable.
- There was unanimous support for the introduction of a 'slip rule' to allow adjudicators to correct obvious errors in their decisions, but there was one objection to the proposal to allow up to a week for such corrections to be made.
- Views expressed on proposals seeking to clarify matters following the House of Lords judgement in *Melville Dundas v George Wimpey* were sharply divided. In this landmark case, their Lordships decided, by a majority, that withholding notices as prescribed in Section 111 of the Construction Act do not always need to be served for payments to be withheld validly.



## THE CONTEXT OF THE CONSULTATION

The consultation document, *“Improving Payment Practices in the Construction Industry in Northern Ireland”*, set out the Department’s proposals to amend the Construction Contracts Order (Northern Ireland) 1997 (‘The Construction Contracts Order’) and The Scheme for Construction Contracts in Northern Ireland Regulations (Northern Ireland) 1999 (‘The Scheme’).

The Construction Contracts Order and The Scheme became effective in 1999 in the wake of originating legislation in GB, in the form of Part II of the Housing Grants, Construction Regeneration Act 1996 and The Scheme for Construction Contracts (England and Wales) Regulations 1998 (‘The Construction Act’ and ‘The Scheme’).

While the Construction Act was generally perceived to be working well, it was accepted that some improvements would be helpful. The wider context for DFP’s proposals to amend the Construction Contracts Order therefore reflects the outcome of a number of public consultations carried out in GB<sup>1</sup> by the Department for Business Innovation and Skills (BIS) and subsequent consultation with a sounding board of key industry figures and the Construction Umbrella Bodies Adjudication Task Group. The Scottish Government had also carried out its own consultation, but later opted for inclusion within the proposals for England and Wales.

These lengthy and exhaustive exercises have led to proposed amendments to the Construction Act which are set out in Part 8 of The Local Democracy, Economic Development and Construction Bill currently in progress through Parliament.

DFP’s consultation exercise sought responses from the construction industry and interested bodies, public and private, as well as the views of individuals to its proposals to amend the Construction Contracts Order (Northern Ireland) 1997. This consultation followed the similar exercises conducted by the BIS in England and Wales and by the Scottish Executive in 2007.

In the belief that prompt and fair payment practice throughout construction supply chains will better enable the industry routinely to adopt integrated working as the norm, DFP’s proposals set out to:-

- encourage parties in dispute in construction contracts to resolve their differences through adjudication, where it is appropriate, rather than by resorting to more costly and time consuming solutions such as litigation;
- improve transparency and clarity in the exchange of information relating to payments to enable cash flow to be managed better; and

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<sup>1</sup> The initial consultations in 2005 and 2007 were carried out in England and Wales in conjunction with the Welsh Government by the Department for Trade and Industry (DTI), which preceded the Department for Business, Enterprise and Regulatory Reform (BERR) before becoming the current Department for Business, Innovation and Skills (BIS).

- improve the facility to suspend performance under the contract.

DFP is proposing to do this by:

**On adjudication:**

- improving access to the right to refer disputes for adjudication by:
  - applying the legislation to oral and partly oral contracts;
  - preventing the use of agreements that interim payment decisions will be conclusive to avoid adjudication on interim payment disputes; and
- ensuring the costs involved in the process are fairly allocated.

**On payment:**

- preventing unnecessary duplication of payment notices;
- clarifying the requirement to serve a Article 9 (2) payment notice;
- clarifying the content of payment and withholding notices;
- ensuring the payment framework creates a clear interim entitlement to payment; and
- prohibiting the use of pay-when-certified clauses.

**On suspension:**

- improving the statutory right to suspend performance by allowing the suspending party to claim the resulting costs and delay.

As such, DFP's proposals represent proportionate reforming amendments to the existing framework rather than wholesale change. Each is intended to address a specific issue that has arisen since the Construction Contract Order has been in operation. Guidance remains the preferred route to improve the operation of construction contracts and the further legislative intervention proposed has only been considered where it is believed to be absolutely necessary.

DFP sought the views of the construction industry and its clients, through this consultation process, on:

- whether DFP's package of proposals properly and adequately addresses the weaknesses in the existing legislation; and
- how DFP might evaluate the costs and benefits of the package of amendments.

## **Additional copies**

You may make copies of this document without seeking permission, or by downloading from the consultation zone of the Department of Finance and Personnel website:

<http://www.dfpni.gov.uk/index/about-us/consultation-zone.htm>

## **Help with Queries**

If you have any questions about the policy issues raised in this consultation exercise, these should be addressed to:

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Central Procurement Directorate,  
Department of Finance and Personnel,  
Clare House,  
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Tel : 028 9081 6483

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## **Comments and Complaints**

If you have any other observations, or wish to make a complaint about the substance or conduct of this consultation exercise, please contact:

Business Planning and Co-ordination Branch,  
Central Procurement Directorate,  
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## CHAPTER 1: ADJUDICATION

### Consultation proposals:

1. Removing the requirement that the Construction Contracts Order should apply only to contracts in writing.
2. Prohibiting agreements that interim or stage payments decisions will be conclusive.
3. Introduction of a statutory framework for the costs of adjudication.

### Responses:

#### **1. Removing the requirement that the Construction Contracts Order should apply only to contracts in writing.**

There was unanimous support for this proposal. It is believed that many parties to construction contracts, disproportionately SMEs, may be deterred from seeking resolution of disputes through adjudication where their contracts are not wholly in writing or, even if initially in writing, have subsequently been amended orally, especially following the Appeal Court judgement in *RJT v DM Engineering (NI) Ltd*.

One respondent commented,

*“Although it is recognized that in the limited time frame available in adjudications, certainty and clarity of the contract terms upon which the Adjudicator is asked to make his decision is desirable, the benefits of not preventing the use of adjudication where the parties have not recorded in writing their contract and of avoiding unnecessary arguments about the Adjudicator’s jurisdiction, where it is not clear that all of the main terms have been recorded in writing, outweigh the disadvantages of the Adjudicator being asked to make a decision on a contract that is not or is not wholly in writing.”*

The proposal that the terms of an adjudication Scheme required by Article 7 of the Construction Contracts Order should only be effective if agreed in writing was also supported unanimously. One respondent suggested that the Scheme for Construction Contracts should be adopted as the one adjudication scheme for the industry, dispensing with the multitude of bespoke schemes currently in use.

None of the respondents felt that the proposal to include oral, or partly-oral, contracts would be likely to encourage parties to agree oral contracts resulting in more oral agreements, due to the wider commercial benefits of having written agreements.

Respondents offered estimates of the proportion of contracts they considered contained non-trivial terms which have been subject to oral agreement or variation. These ranged widely from (0% - 10%) to (50% - 75%).

All respondents supported the proposal that an agreement under paragraph 2, or 5(2), of Part 1 of The Scheme, as to who should act as adjudicator, should only be effective if agreed in writing.

## **2. Prohibiting agreements that interim or stage payments decisions will be conclusive.**

All respondents agreed with the proposal that the Construction Contracts Order should be amended to prohibit agreements that decisions as to the amounts of payments whether by instalment, stage or other periodic payment are conclusive.

While some concern was expressed about the desirability of parties being free to contract as they see fit, instances where agreements include provision for interim payments to be conclusive usually result from situations where one party is in a stronger negotiating position than the other, thus belying the notion of the parties' apparent freedom of contract.

All again agreed that the prohibition of agreements that decisions are conclusive should include decisions as to the amounts of stage payments and decisions relating to work that has been performed under the contract to the extent that it affects the amount of the payment.

Questions on whether final payment decisions and decisions on payment that have already been taken and notified to the parties should be excluded drew a mixed response. While some accepted DFP's proposal, one respondent expressed the view that the exclusion of final payments could adversely impact on sub-contractors through final payments, especially on sub-contracts of short duration, being undervalued.

## **3. Introduction of a statutory framework for the costs of adjudication.**

There was strong, but not unanimous, support for the proposal to prohibit agreements on the allocation of the costs of adjudication until after the adjudicator was appointed. One respondent disagreed.

Strong support was also expressed for the proposal that the adjudicator should have no jurisdiction as to allocation of costs unless the parties have so agreed after the appointment of the adjudicator. Again, one respondent disagreed.

All respondents agreed that adjudicators should be statutorily entitled to claim a reasonable amount for fees and expenses.

DFP's proposals: (i), that the courts should have jurisdiction to decide the reasonableness of adjudicators' fees and expenses, when claimed under the proposed statutory right, (ii), that the legal and other costs of the parties are

reasonable, where the parties have agreed that the adjudicator should make a decision and (iii), that the parties should be jointly and severally liable for this amount, met with a mixed, but essentially positive response.

For example, one respondent felt strongly that costs should be kept out of the adjudication process altogether, while another was unclear about the underlying intention:

*“If the proposal is to reserve the quantum of costs to the master of the High Court in any circumstances where it is not agreed, then I do not support it. That would be extremely onerous. If the purpose is to ensure that the adjudicator deciding this is not finally binding then I would have thought that the general provision to allow it to be temporarily binding subject to litigation, arbitration or agreement (as his decision on substantive issues is) would be the best solution. However, I do maintain that we should follow what is decided in GB on this.”*



## **CHAPTER 2: PAYMENT FRAMEWORK**

### **Consultation Proposals**

1. Prevention of unnecessary duplication of payment notices;
2. Clarification of the requirement that an Article 9 (2) payment notice should be served;
3. Clarity of the content of payment and withholding notices;
4. Clarity of the sum due; and
5. Prohibiting the use of pay-when-certified clauses.

### **Responses**

#### **1. Prevention of unnecessary duplication of payment notices**

Support was unanimous for the proposal that the Construction Contracts Order be amended so that a certificate from a third party supervising officer under a contract which makes a valuation of the work done may function as an Article 9 (2) payment notice.

There was also across-the-board support for the proposal that the Construction Contracts Order should allow the contract to provide that an Article 9 (2) payment notice may be issued by either the payer or a person identified in the contract. Broad support was given to this facility being extended to include a person identified in a notice to the payee.

All respondents agreed that The Scheme should provide that a payment notice under Part II paragraph 9 may be issued by either the payer or by a person identified in the contract.

#### **2. Clarification of the requirement that an Article 9 (2) payment notice should be served**

Broad support was offered for the proposal that the drafting of the provision in Article 9 (2) on when it is necessary to issue an Article 9 (2) payment notice should be improved to achieve greater clarity. However, one dissenting respondent opined that this issue should be addressed by more guidance rather than by legislation, while another, though supporting the proposal, expressed concern that it appeared in their view to promote cross-contract setting-off.

The consultation document stated that an Article 9 (2) payment notice may only be issued for some 40% of payments. Respondents were asked to gauge what proportion of cases, where the notice is not issued, can be explained by the current deficiencies in the requirement in Article 9 (2) of the Order. The responses received ranged from the 10% - 33% band to more than 90%.

### **3. Clarity of the content of payment and withholding notices**

Again broad support was received for the proposal that Article 9 (2) should be amended to require that, in addition to the amount of the payment made, or proposed to be made, and the basis of calculation, payment notices should also state, (i), the amount withheld, where the payment is less than the amount that would have been due had the payee performed all his obligations under the contract and where there were no set-off or abatement, (ii), the grounds for withholding and, (iii), the basis of calculation of any amounts withheld.

However, one respondent disagreed, commenting that unless the payment notice and withholding notice are to be amalgamated into one notice, it does not seem appropriate to require details to be set out in the payment notice and that to do so may add confusion as to the purpose of the payment notice.

### **4. Clarity of the sum due**

All respondents agreed with the proposal that the Order should be amended to ensure that the payer and payee should both know the sum due for the purpose of Article 10 so that deductions can only be made from that sum by issuing a withholding notice and that both parties should know the amount that must be paid if the payer is to avoid the possibility that payee will suspend performance.

While all again agreed that the sum due under a construction contract should be the amount as specified in an Article 9 (2) payment notice, one respondent dissented from the proposal that, where no payment notice is issued, the amount due should be the amount claimed by the payee.

### **5. Prohibiting the use of pay-when-certified clauses.**

All respondents agreed that the Construction Contracts Order should be amended to make clear that pay-when-certified clauses are not an adequate mechanism for determining when payment becomes due.

One respondent strongly supported this proposal while another acknowledged that although it may result in some hardship for those in the middle of a contractual chain, who are both awaiting payment as payee and having to pay out as payers, the principle established by the prohibition of 'pay-when-paid' clauses, that payment for work done should not be dependent on the actions (or inaction) of a third party, also applies to 'pay-when-certified'.

## **CHAPTER 3: IMPROVING THE RIGHT TO SUSPEND PERFORMANCE**

### **Consultation Proposals**

1. Provision that the suspending party may claim reasonable costs and extension of time following its exercise of the right to suspend and may suspend contractual obligations in default of payment.

### **Responses**

DFP's proposals were agreed by all respondents. One emphasised that for the remedy to be effective, it would be necessary for the party suspending performance to be paid the costs of suspension, but that the rights so prescribed should be properly exercised and the costs reasonable and demonstrable.



## CHAPTER 4: OTHER ISSUES WHICH ARE BEING CONSIDERED AS PART OF THIS CONSULTATION

### Consultation Proposals

1. Minimising divergence;
2. Introduction of 'slip rule' to enable correction of error; and
3. The judgement of the House of Lords in *Melville Dundas v George Wimpey*.

#### 1. Minimising divergence

There was emphatic and unanimous agreement to the proposal to seek parity with GB legislation. The commonality of case law for reference in disputes and the desirability of maintenance of common commercial practice were cited as principal reasons.

#### 2. Introduction of 'slip rule'

The proposal to introduce a 'slip rule' to enable correction of error was welcomed, but one respondent felt that a period of one week to allow an adjudicator to make a correction was too long, while another thought this period to be reasonable.

#### 3. The judgement in *Melville Dundas Ltd (in receivership) v George Wimpey and others*, House of Lords, [2007] UKHL18

There were sharp differences in viewpoint in respect of DFP's proposals which are aimed at clarifying the legal position following this case. DFP is proposing that Article 10 of the Construction Contracts Order (which corresponds with Section 111 of the Construction Act) should not apply in cases of insolvency, but should apply in all other cases.

While one respondent stated its lack of support for this proposal and spoke of its conviction that withholding notices should be issued on every occasion with no exceptions to the rule, another expressed the view that the insolvency exception as proposed is necessary on the grounds of the hardship involved if payments to insolvent payees are required.



## **CHAPTER 5: PARTIAL REGULATORY IMPACT ASSESSMENT**

None of the responses indicated concern that any of the nine categories of persons as set out in Section 75 of the Northern Ireland Act 1998 is likely to be adversely affected by, or suffer disadvantage through, implementation of the proposed amendments to the Construction Contracts Order.



## **THE WAY FORWARD AND THE NEXT STEPS**

The responses to the consultation exercise which are summarised in this report will help inform DFP's detailed proposals to amend the Construction Contracts Order and the development of draft Bill clauses. In particular, in view of the unanimously expressed wish to secure parity with current proposals in GB, the progress of the amending legislation in GB will be closely monitored.

DFP wishes to express its thanks to all those who responded to the consultation exercise and for the valuable comments offered.