



# CLLS Construction Law Committee

Foundation Level Training – Day 2



The City of London Law Society





# CLLS - Foundation Level Construction Training The Construction Act – Payment Provisions

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8<sup>th</sup> November 2019



# Why does the Act exist at all?

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- Bad behaviour by Main Contractors
- Unfair withholding of payment
- Inequality of bargaining power
- Strong lobbying by Sub-Contractors
- The SME agenda
- The Latham Report – “Constructing the Team”

## So what is it?

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- **Part II of the Housing Grants, Construction and Regeneration Act 1996 (also known as the “Act”, the “Construction Act” or the “HGCRA”)**
- **As amended by Part 8 of the Local Democracy, Economic Development and Construction Act 2009**
- **The Scheme for Construction Contracts (England and Wales) Regulations (SI 1998/649) as amended by the Scheme for Construction Contracts (England and Wales) Regulations 1998 (Amendment) (England) Regulations 2011 (SI 2011/2333) (also known as the “Scheme”)**

# Construction Act and Scheme – an overview

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- Construction Act and Scheme came into operation in England and Wales on 1 May 1998
- Amended by the LDEDCA (effective October 2011)
- Key points:
  - to improve efficiency in the construction supply chain
  - to create a clear fair payment regime and encourage quick resolution of disputes through adjudication
  - applies to all written and oral “construction contracts” (s104) for “construction operations” (s105)
  - Scheme - fall back payment and adjudication provisions

# What happens if your contract is not compliant?

**Adjudication (s108)**  
Implied in full

**Payment (ss109-111)**  
Implied piecemeal

**Suspension (s112)**  
Applies regardless of contract

# Exclusions

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# Payment

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- Key payment provisions: s109-113 Construction Act
- Apply where:
  - contract is a “construction contract” for purposes of the Construction Act (s104 and s105)
  - over 45 days in duration (s109)
- If applicable, payment regime must contain an “adequate mechanism” for determining what payments become due and when (s110(1)(a))





# Requirements of a compliant payment regime

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- Contractual payment regime must include:
  - periodic payments (ie stage payments/milestones) (s109)
  - method for determining how much is due (s110(1)(a))
  - Due Date for Payment (s110(1A-D))
  - Final Date for Payment (s110(1)(b))
- Parties free to agree period of time between Due Date for Payment and Final Date for Payment (s110(1))

# Two separate notices

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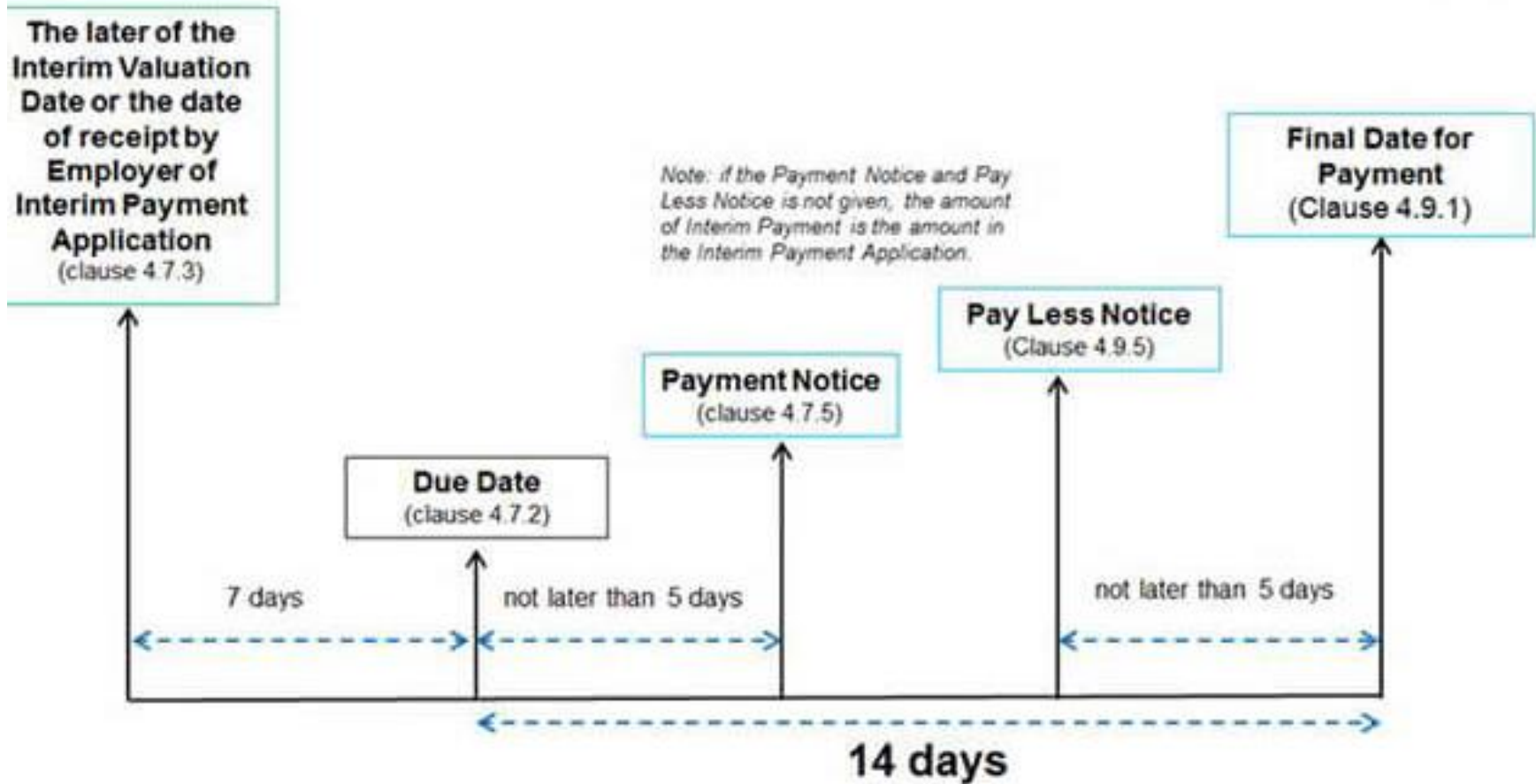
## Payment notice (s110A(1))

- Set out amount due (“**notified sum**”) and basis of calculation, even if amount £0
- Serve within 5 days after Due Date
- Served by payee, payer or “specified person” on behalf of payer

## Pay less notice (s111(3))

- Inform payee before the Final Date for Payment of any amount the payer intends not to pay, and the grounds for doing so
- Parties can agree the period before the Final Date for Payment prior to which the Pay Less Notice must be served (“**prescribed period**”)
- Payer cannot withhold payment if notice not issued

# JCT Design and Build 2016 Payment Cycle



# What happens if payer does not issue Payment Notice?

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- Payee may issue Default Payment Notice (section 110B) - sets out amount payee considers due (or having been due at the Due Date for Payment) and the basis on which such amount is calculated
- Payer can (and should) still issue Pay Less Notice in response
- If payee serves a Default Payment Notice, Final Date for Payment extended

# Suspension

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- Suspension (s112):
  - Right to suspend all or part of the work for non-payment
  - If no effective Pay Less Notice is served, the unpaid party can suspend works where an amount is withheld from payment
  - Must give 7 days notice
  - Ceases upon payment of full amount due
  - No right to suspend if:
    - an effective Pay Less Notice has been served; and
    - the amount specified in the notice has been paid
  - Unpaid party entitled to:
    - payment of a reasonable amount of costs and expenses reasonably incurred in consequence of suspension
    - an extension of time for the period of suspension and consequential delay (e.g. remobilisation)

# Pay when paid – what is it?

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## Pay when paid

Contractor does not pay subcontractor until it is paid

Prohibited by s113

Exception: insolvency

## Pay when certified

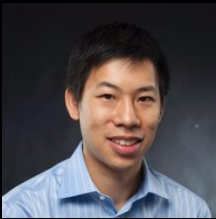
Adequate mechanism for payment, but linked to obligations under another contract

Post October 2011,  
prohibited by S110(1A)



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**Friday, 8 November 2019**

# Background

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- Contractual adjudication in construction
  - SEACC (Electrical Contractors' Association)
  - New Engineering Contract (1993)
  - IChemE – similarities in expert determination
  - FIDIC White Book, 5<sup>th</sup> Edition
  - JCT “commercial” contracts for exempted parties
- Statutory adjudication
  - Final “Latham Report” (1994)
  - Mandatory
  - HGCR 1996 (as amended)
  - The Scheme for Construction Contracts (as amended)
  - Ensures cashflow





# Statutory adjudication

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- Section 108(1)

- *"A party to a **construction contract** has the right to refer a dispute arising under the contract for adjudication under a procedure **complying with this section** ... For this purpose "dispute" includes any difference."*

- Section 108(2)

- *The contract shall include provision in writing so as to—*
  - (a) *enable a party to give notice **at any time** of his intention to refer a dispute to adjudication*
  - (b) *provide a timetable with the object of securing the appointment of the adjudicator and referral of the dispute to him within 7 days of such notice*



# Contract must provide for adjudication

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- Section 108(2)
  - *The contract shall include provision in writing so as to—*
    - (c) require the adjudicator to reach a decision **within 28 days of referral** or such longer period as is agreed by the parties after the dispute has been referred*
    - (d) **allow the adjudicator to extend the period of 28 days by up to 14 days**, with the consent of the party by whom the dispute was referred*
    - (e) impose a duty on the adjudicator to act **impartially**; and*
    - (f) enable the adjudicator to take the initiative in ascertaining the facts and the law*



# Interim-binding and the slip rule

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- Section 108(3)

- *The contract shall provide in writing that the decision of the adjudicator is **binding until the dispute is finally determined by legal proceedings, by arbitration** (if the contract provides for arbitration or the parties otherwise agree to arbitration) **or by agreement***
- *The parties may agree to accept the decision of the adjudicator as finally determining the dispute*

- Section 108(3A)

- *The contract shall include provision in writing permitting the adjudicator to correct his decision so as to remove a clerical or typographical error arising by accident or omission*



# Adjudicator's liability and the Scheme

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- Section 108(4)
  - *The contract shall also provide in writing that the adjudicator is not liable for anything done or omitted in the discharge or purported discharge of his functions as adjudicator unless the act or omission is in **bad faith**, and that any employee or agent of the adjudicator is similarly protected from liability*
- Section 108(5)
  - *If the contract does not comply with the requirements of subsections (1) to (4), the adjudication provisions of **the Scheme for Construction Contracts** apply*



# Costs and Tolent clauses

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- Section 108A

(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

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



# The Scheme for Construction Contracts

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- Supplements Sections 108 and 108A
- Rules for conduct of an adjudication
  - Notice of Adjudication (by Referring Party)
  - Nomination of Adjudicator (by Referring Party)
  - Referral Notice (by Referring Party)
  - Powers of Adjudicator
    - May take into account any other matters which parties agree should be within the scope of adjudication or which are matters under the contract which he considers are necessarily connected with the dispute
    - May open up, revise and review any decision taken or certificate given by person referred to in contract unless contract states that decision or certificate final and conclusive



# The Scheme for Construction Contracts

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- Powers of Adjudicator
  - May decide that a party liable to make payment under contract and when payment due and payable
  - Can he award interest?
  - Provide reasons for decision (if requested)



# Dispute or claim?

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- What is a “dispute”?
  - *AMEC Civil Engineering Ltd v Secretary of State for Transport* [2004] EWHC 2339 (TCC)
  - Must have crystallised
  - Can't have been previously adjudicated
  
- Dispute or disputes?
  - Just one but can amend contract
  - How many contracts?
  - How many parties?
    - *Yuanda (UK) Co Ltd v W W Gear Construction Ltd* [2010] EWHC 720 (TCC)





# Advantages of adjudication

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- Speed
  - Must make decision
  - Pay now, argue later
  - 28-day process (and quick enforcement in TCC)
  - No need for Pre-Action Protocol, lower cost
- Flexibility
  - As long as complies with s. 108
  - Can choose adjudicator with appropriate expertise
  - Adjudicator can investigate claim
- Confidentiality
  - Unless enforced in TCC



# Disadvantages of adjudication

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- May not suit all disputes
  - Rough and ready - 28 days not a long time
  - Insolvency risk
    - *Wimbledon Construction Company 2000 Ltd v Vago* [2005] EWHC 1086 (TCC)
- Christmas is ruined (or other holidays)
  - Ambush
- Can't consolidate disputes unless consent obtained
  - Same breach under multiple contracts, limited jurisdiction
- Recovery of legal costs
  - s. 108A – costs only recoverable if contract provides or agreed after Notice of Adjudication



# Enforcement of decisions

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- *Macob Civil Engineering Ltd v Morrison Construction Ltd* (1999) 15 Const LJ 300 (TCC)
  - Adjudicator's decision binding until final determination
- Grounds for challenging enforcement
  - No jurisdiction (was right to challenge reserved?)
  - Lateness
  - Overpayment can be recovered on final determination or, in appropriate circumstances, in a later adjudication of a different dispute
  - Breach of natural justice, e.g. bias
  - Fraudulent misrepresentation
  - TCC will not interfere if error in procedure, fact or law (but cf. *Steve Domsalla v Kenneth Dyason* [2007] EWHC 1174 (TCC) and contractual adjudication)



# Other issues

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- Some popular adjudication procedures:
  - TeCSA
  - TECBAR
  - JCT
  - CIC
  - Note: *Aveat Heating Ltd v Jerram Falkus Construction Ltd [2007] EWHC 131 (TCC)*
- Collateral warranties subject to adjudication but not third party rights
- Popularity growing outside UK – Eire, Singapore, Malaysia, Australia, New Zealand, Canada

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# **City of London Law Society Construction Law Foundation Training**

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8 November 2019

# Summary of Content

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Main areas to look at:-

- I. The Contractor's obligation to complete the works.
- II. Liquidated Damages for the Employer for delay to completion.
- III. Extensions of time and the "prevention principle".

# I. The Contractor's Completion Obligation

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- “Delay” is a relative concept – depends on when the works are supposed to be completed.
- Starting point = the Contractor's obligation to complete the works.
- Example, JCT Standard Form:

Clause 2.4:

*“...the Contractor...shall regularly and diligently proceed with and complete [the Works] on or before the relevant Completion Date.”*



# I. The Contractor's Completion Obligation (Cont'd)

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- This is a strict obligation (not “reasonable endeavours”).
- If the Contractor does not complete the Works by the Completion Date, he is in breach.
- It is not for the Employer to prove how or why the Contractor failed to complete the Works on time.
- Other / different types of completion obligation:-
  - (a) Sectional completion / multiple completion dates for different parts of the Works (option included in JCT forms).
  - (b) Obligations to achieve certain interim milestones in the project programme.

## II. Liquidated Damages

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- Assumed facts: the Contractor has not completed the works by the Completion Date.
- In construction contracts – time is not normally “of the essence”.
- Remedy is not termination.
- Under most standard forms, the Employer is entitled to deduct or recover “liquidated damages” for the period between the Completion Date and the actual date of practical completion.
- Cf. Sub-contracts where most forms require the Contractor to prove actual loss caused by the sub-contractor’s late completion.

## II. Liquidated Damages (Cont'd)

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- Liquidated damages are damages for breach of contract.
- “Liquidated” means that the rate of damages have been agreed and specified in the contract: e.g. “£100,000 per week”.
- Benefit for Employer – the Employer does not have to prove his actual losses for late completion.
- Benefit for Contractor – the Contractor knows what his liability for late completion will be.
- Larger contracts (e.g. for international projects) also typically contain caps on the liquidated damages.

## II. Liquidated Damages (Cont'd)

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- Liquidated damages will normally be an exclusive remedy for delay to completion.
- Thus – if the Employer actually suffers more loss, he cannot recover it.
- In this way, LDs are a limitation of liability for the Contractor.
- Also, if the Employer does not suffer so much loss, this is no defence for the Contractor (cf. some civil law jurisdictions).
- If LDs are described as “nil” – this has been held to mean no damages at all for delayed completion (*Temloc Limited v Errill Properties* [1987] 39 BLR 30)!

## II. Liquidated Damages (Cont'd)

- How to set liquidated damages?
- Main principle used to be: LDs must be a “genuine pre-estimate” of the loss that will be suffered at the time of contract.
- Otherwise, the LDs would be an unenforceable penalty.
- As of 2015, that significantly changed... Supreme Court Judgment in Cavendish v Makdessi / ParkingEye v Beavis [2015] UKSC 67
  - (a) *“the law relating to penalties has become the prisoner of artificial categorisation, itself the result of unsatisfactory distinctions: between a penalty and genuine pre-estimate of loss, and between a genuine pre-estimate of loss and a deterrent.”* (per Lord Neuberger, para. 31)
  - (b) *“The true test is whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation.”* (per Lord Neuberger, para. 32)
  - (c) *“The penalty rule is an interference with freedom of contract. It undermines the certainty which parties are entitled to expect of the law.”* (per Lord Neuberger, para. 33)

## II. Liquidated Damages (Cont'd)

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- (d) *“...the circumstances in which the contract was made are not entirely irrelevant. In a negotiated contract between properly advised parties of comparable bargaining power, the strong initial presumption must be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of breach.”* (per Lord Neuberger, para. 35)

Applied to the facts in one of the appeals...

- (e) *“Although clause 5.1 has no relationship, even approximate, with the measure of loss attributable to the breach, Cavendish had a legitimate interest in the observance of the restrictive covenants which extended beyond the recovery of that loss... The fact that some breaches of the restrictive covenants would cause very little in the way of recoverable loss to Cavendish is therefore beside the point.”* (per Lord Neuberger, para. 75)

And on the other (parking penalty charges)...

- (f) *“...deterrence is not penal if there is a legitimate interest in influencing the conduct of the contracting party which is not satisfied by the mere right to recover damages for breach of contract.”* (per Lord Neuberger, para. 99)

## II. Liquidated Damages (Cont'd)

- (g) *“What is necessary in each case is to consider, first, whether any (and if so what) legitimate business interest is served and protected by the clause, and, second, whether, assuming such an interest to exist, the provision made for the interest is nevertheless in the circumstances extravagant, exorbitant or unconscionable.”*
- (h) *“In judging what is extravagant, exorbitant or unconscionable, I consider (despite contrary expressions of view) that the extent to which the parties were negotiating at arm’s length on the basis of legal advice and had every opportunity to appreciate what they were agreeing must at least be a relevant factor.”* (per Lord Mance, para. 152)
- So: now appears to be greater scope for commercial parties to determine rates for LDs for breaches, and to set these at more than the general damages that might be claimed for breach of the obligation
  - Consistent with trend in case law in favour of enforcing commercial contracts as they are written (*Arnold v Brittan* (2015), *Grove v Balfour Beatty* (2016)).
  - Rule against penalties may be applied outside LDs – e.g. transfer of property, withholding of money upon breach.
  - Where clause involves withholding money / loss of property, the equitable doctrine of relief from forfeiture may also apply (focus on time after breach).

## II. Liquidated Damages (Cont'd)

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- Also – remember if there is Sectional Completion:-
- There must be a separate completion date for each section of the works.
- There must be a separate rate of LDs for each section of the works.
- Often see mistakes here.
- Formalities must be strictly complied with.
- For example, under the JCT standard form:-
  - (a) The Contract administrator must have issued a Notice of Non-Completion; and
  - (b) The Employer must have informed the Contractor before the Final Certificate that he may enforce payment / deduction of LDs; and
  - (c) If the Employer wants to deduct the LDs from sums otherwise due to the Contractor then, not later than 5 days before the “final date for payment” of the interim payment / final payment, the Employer must give the required “Pay Less” notice (i.e. explaining the amount to be withheld and the grounds).



### III. Extensions of Time

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- Standard forms of contract provide grounds for the Completion Date to be extended (or the Completion Dates for each Section).
- When an extension is granted, LDs will run from the extended Completion Date (see *Balfour Beatty v Chestermount* (1993) recently re-affirmed by TCC and Court of Appeal in *Carillion v EMCOR*).
- For whose benefit?
  - (a) The Contractor – obviously benefits from having more time before LDs start to run.
  - (b) The Employer – also benefits (but less obviously) because the Extension of Time mechanism is crucial to protecting his right to recover LDs.

### III. Extensions of Time (Cont'd)

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- Explanation – the “Prevention Principle”.
- Common law principle – if the Employer has done anything to prevent the completion of the work, he loses his ability to recover LDs.
- The exception to this – where the contract allows the Completion Date to be extended where the Employer has delayed the completion of the works.
- So the Extension of Time (“EOT”) clause is important for the Employer too: to preserve his right to recover LDs.

### III. Extensions of Time (Cont'd)

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- Grounds for extension of time vary in different forms of contract.
- Basically, grounds for extension (called “Relevant Events” in the JCT form) fall into two categories:-
  - (a) Delays caused by the Employer (e.g. instructing the Contractor to perform additional works).
  - (b) Delays not caused by the Employer (e.g. “exceptionally adverse weather conditions”).
- The parties can increase / restrict the Relevant Events in Category (b) without undermining the Employer’s right to LDs.

### III. Extensions of Time (Cont'd)

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- Procedure for Extensions of Time:-
- The Contractor will normally be expected to give notice to the Employer / Contract Administrator giving details of any delay, and whether it constitutes grounds for an EOT.
- Some forms of contract (especially bespoke forms) require notice of delay to be given within a specified period (e.g. within 14 days of the delay) as a condition precedent to the Contractor's entitlement.
- Australian case (*Gaymark Investments v Walter Construction*) held that such notice requirements could result in the Employer being prevented from recovering LDs.
- Scottish case (*City Inn v Shepherd Construction*) held that the notice provisions were enforceable, and the Employer could recover LDs.

### III. Extensions of Time (Cont'd)

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- Position in England?
- Comment by Jackson J. (*Multiplex Constructions v Honeywell Control Systems* [2007] 1 BLR 195):-

*“I have considerable doubt that Gaymark represents the law of England. Contractual terms requiring a contractor to give prompt notice of delay serve a valuable purpose; such notice enables matters to be investigated while they are still current. Furthermore, such notice sometimes gives the employer the opportunity to withdraw instructions when the financial consequences become apparent. If Gaymark is good law, then a contractor could disregard with impunity any provision making proper notice a condition precedent.”*
- Condition precedent of delay notice also accepted by Hamblen J. in *Adyard Abu Dhabi v SD Marine* (2011).
- Suggest: issue will be more about what the notice clause reasonably required, and also when the time period for notice to be given actually started: see Akenhead J. in *Obrascon Huarte Lain SA v Attorney General for Gibraltar* (2014).

### III. Extensions of Time (Cont'd)

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- How to assess a request for extension of time?
- Delay analysis can be very complex.
- Establish the facts – What happened? Is it a Relevant Event?
- Does the delay impact the contractor's completion of the works by the Completion Date (i.e. is it a “critical” delay)?
- Identify the “critical path” for the works – i.e. the longest sequence of particular activities that must be completed in order to finish the project.
- The delay may only affect other activities which are non-critical – i.e. they can be completed in parallel with the “critical” works without delaying the completion date.
- Also to consider the extent of the Contractor's obligations to minimize / mitigate any delays.

# City of London Law Society Construction Law Foundation Training



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# ALLEN & OVERY



## *City of London Law Society – Foundation Level Training*

Eleanor Milne, Allen & Overy LLP

Defects, 8 November 2019



# Defect Defined

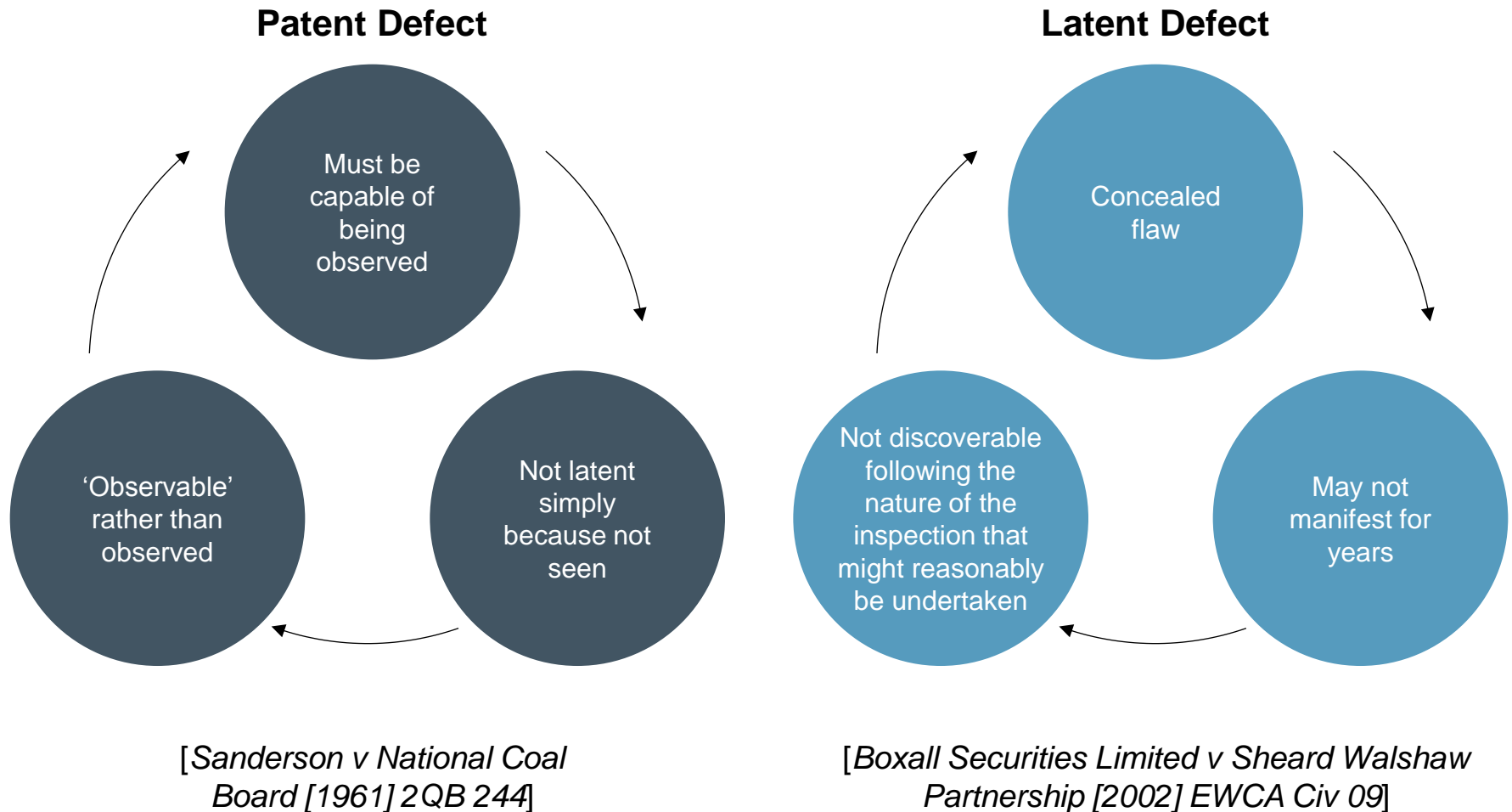
## Not contractually defined

- “anything which renders the [works] unfit for the use for which it is intended, when used in a reasonable way and with reasonable care” [ *Yarmouth v France (1887) 19 QBD 647* ]
- Anything within the works that does not conform to the contractual requirements relating to quality of design, materials or workmanship

## Contractually defined (preferred A&O approach)

- **Defect** means any part of the Works which is not in accordance with, or fulfilling the requirements of the Contract.

# Types of Defects: Patent and Latent Defects



# Liability for Defects

## Pre-Completion

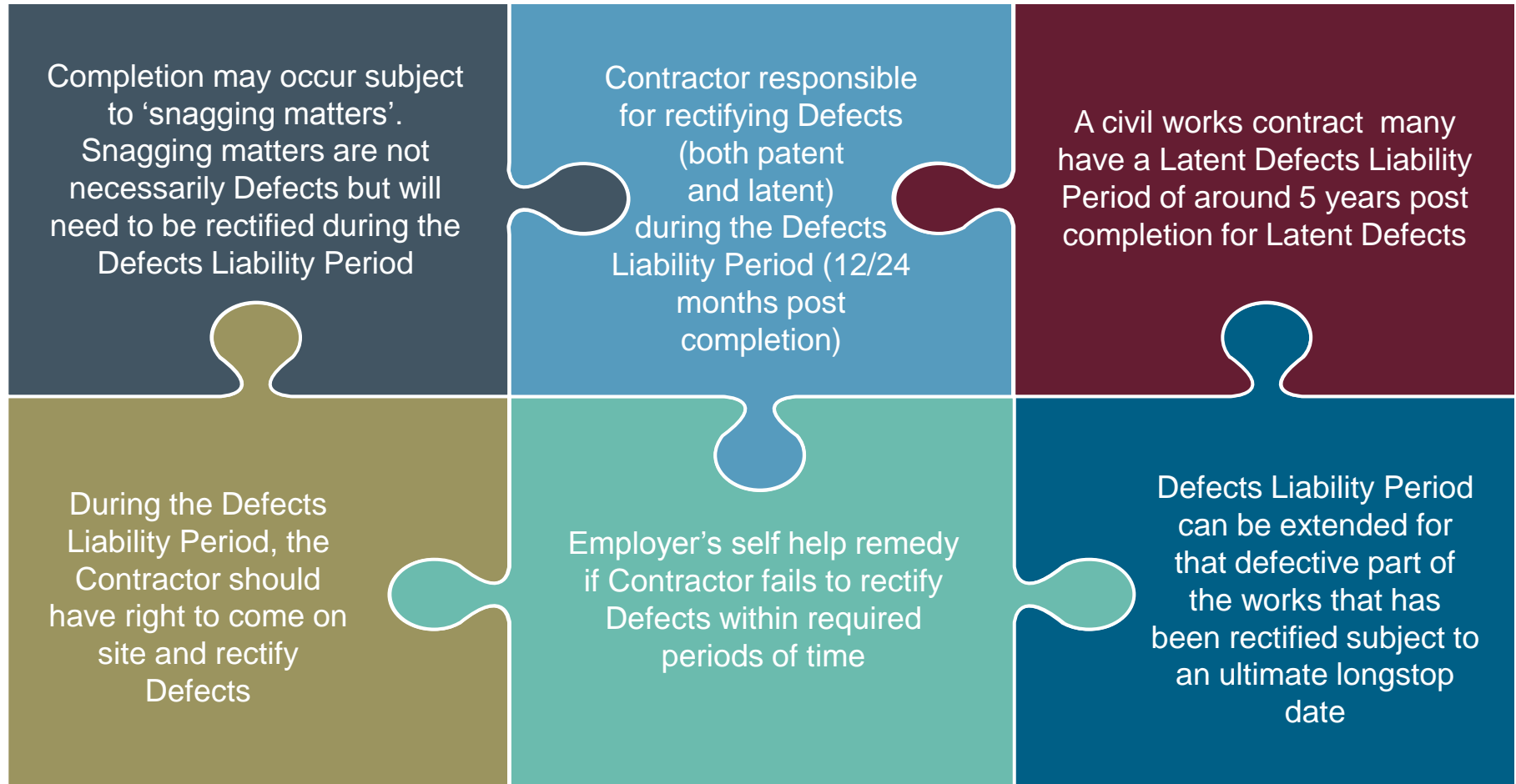
Contractor responsible for rectifying all Defects prior to completion

Ensure this by defining conditions of completion to include Works being free from Defects

Contract should provide for remedies for defective works prior to completion, including rights to inspect prior to covering up and a right to uncover if defective works are suspected

# Liability for Defects

## Post-completion



# Notice or certificate of making good Defects

01

Standard and bespoke construction contracts typically require the Employer to issue a notice or certificate confirming that Defects notified during the Defects Liability Period have been 'made good' or 'rectified'.

02

The effect of such notices / certificates can be conclusive on evidence, depending upon how they are drafted, that all Defects (whether notified or otherwise) have been discovered and rectified and that the Contractor has no further liability. This would cut across the general law position that Defects discovered after the expiry of the Defects Liability Period are breaches of contract and should be avoided.

# Questions?

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