IMPROVING PAYMENT PRACTICES IN THE CONSTRUCTION INDUSTRY
2nd Consultation on proposals to amend Part II of the
Housing Grants Construction and Regeneration Act 1996

Response

We should be very grateful if you would answer these questions on the proposals in this consultation paper, and on their potential impacts. Please give reasons for your answers where you think it may be helpful. You should also feel free to suggest alternative approaches or make whatever additional comments or suggestions you think are appropriate.

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Chapter 1 - Adjudication framework

1. Removing the requirement that the Construction Act should only apply to contracts in writing

a) *Do you agree that Section 107 the Housing Grants, Construction and Regeneration Act 1996 should be removed so that the application of Part II of the Construction Act is not restricted to contracts where all the terms are in writing?*
Yes ☑ *No* ☐
Majority view – CC dissenting (see their Response).

b) *Do you agree with us that the terms of an adjudication Scheme required by section 108 of the Construction Act should only be effective if agreed in writing?*
Yes ☐ *No* ☐
No clear view – see individual Responses.

c) *Do you agree with us that the removal of the requirement that the parties must agree a contract in writing in order for the Construction Act to apply is unlikely to encourage the agreement of more oral or partly oral contracts?* *Yes* ☑ *No* ☐
Majority view – CC dissenting (see their Response).

d) *What proportion of contracts as a whole do you consider contain nontrivial terms which have been subject to oral agreement or variation?*
(i) 0%-10% ☐ *(ii) 10%-25%* ☐ *(iii) 25%-50%* ☐
(iv) 50%-75% ☐ *(v) 75%-90%* ☐ *(vi) 90%-100%* ☐
Please select one from (i) to (vi)
CUBATG has no hard evidence but the gut feeling is that it is (iv) but that if recent case law is upheld it could be more than that.

e) *Do you agree with us that an agreement under paragraph 2 or 5(2) of Part I of the Scheme, as to who should act as adjudicator, should only be effective if agreed in writing? Yes ☑ No ☐*

2. Prohibiting agreements that interim or stage payment decisions will be conclusive

a) *Do you agree that the Construction Act should be amended to prohibit agreements that decisions as to the amounts of payments whether by instalment, stage or other periodic payments are conclusive? Yes ☑ No ☐*
Yes – and see comments in individual Responses. "Agreements" should read "contract terms".

b) *Do you agree that the prohibition of agreements that decisions are conclusive should include:*

(i) *Decisions as to the amounts of stage payments (i.e. for completed stages of work)? Yes ☑ No ☐*

ii) *Decisions which relate to the work that has been performed under the construction contract to the extent that it affects the amount of the payment? Yes ☑ No ☐*
Majority view – CCG dissenting (see their Response).

but that it should exclude:

(iii) *Decisions as to the amount of final payment? Yes ☐ No ☐*
CUBATG unable to agree – see individual Responses.

(iv) *Payment decisions that have already been taken and notified to the parties? Yes ☐ No ☐*
Yes – if the question refers to settlement agreements as opposed to unilateral decisions. Majority view – CC dissenting (see their Response).

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

a) *Do you agree with our proposal to prohibit agreements as to the allocation of the costs of the adjudication until after the adjudicator is appointed? Yes ☑ No ☐*
All agree that such agreements reached before an adjudicator is appointed should be prohibited. The majority agree that after the adjudicator is appointed the parties should be free to agree the costs allocation – SEC Group and NSCC dissenting (see their Responses).

b) *Do you agree with our proposal to provide that the adjudicator should have no jurisdiction as to the costs of the adjudication unless the parties have made an agreement to that effect after the adjudicator is appointed? Yes ☑ No ☐*
With the same proviso as (a) above.

c) *Do you agree that adjudicators should be statutorily entitled to claim a reasonable amount in respect of fees for work reasonably undertaken and expenses reasonably incurred? Yes ☑ No ☐*

d) *Do you agree that the courts should have jurisdiction to decide whether:*

(i) *The fees and expenses claimed by the adjudicator are reasonable when they are claimed under the proposed statutory right? Yes ☑ No ☐*

(ii) *The legal or other costs of the parties are reasonable when the parties have agreed that the adjudicator should make a decision as to legal or other costs and that the parties should be jointly and severally liable for this amount? Yes ☑ No ☐*
Majority view – SEC Group has reservations (see their Response). CUBATG do not understand the words underlined.

e) *What proportion of contracts do you think contain an agreement that the referring party (or a specified party) should pay all or part of the costs of the adjudication?*
(i) Less than 0.1% ☐ (ii) 0.1%-0.5% ☐ (iii) 0.5%-l% ☐
(iv) 1%-5% ☐ (v) 5%-10% ☐ (vi) More than 10% ☐
Please select one from (i) to (vi)
CUBATG has not been able to conduct up-to-date research to get firm figures but SEC Group conducted research several years ago, and it is known that such terms exist.

f) *What proportion of adjudications do you think are conducted under contracts containing an agreement that the referring party (or a specified party) should pay all or part of the costs of the adjudication?*
(i) Less than 0.1% ☐ (ii) 0.1%-0.5% ☐ (iii) 0.5%-l% ☐
(iv) 1%-5% ☐ (v) 5%-10% ☐ (vi) More than 10% ☐
Please select one from (i) to (vi)
Same answer as (e) above.

Chapter 4 – Other issues which we are considering as part of this consultation

1. Devolution

a) *Do you agree that the DTI and Welsh Assembly Government should continue to work together to minimise the differences between the effect of the provisions of the Schemes in England and Wales given that responsibility for the Scheme has been devolved to the Welsh Assembly? Yes ☑ No ☐*

b) *Do you agree that, so far as is possible give the differences between Scots law and English law, the DTI and Scottish Executive should continue to work together to*

minimise the differences between the effect of the provisions of the Construction Act in England and Scotland given that responsibility for the Act has been devolved to the Scottish Parliament? Yes ☑ No ☐

c) *Do you agree that, so far as is possible give the differences between Scots law and English law, the DTI and Scottish Executive should continue to work together to minimise the differences between the effect of the provisions of the Schemes in England and Scotland? Yes ☑ No ☐*

2. Correction of errors

a) *Do you consider that the DTI and Welsh Assembly Government should work with the Scottish Executive to develop a "slip rule" with the intention, so far as is possible, of introducing the same rule in England, Scotland and Wales to ensure it is applied in a uniform way by the courts in England and Wales and in Scotland? Yes ☑ No ☐*

b) *Do you agree with the suggestion in the Scottish Executive's report of its consultation on Improving adjudication in the construction industry that a slip rule should provide the adjudicator with:*

(i) *Power to correct a clerical or arithmetic error or any other matter that the parties may agree. Yes ☑ No ☐*
All agreed there should be a power to correct clerical or arithmetical errors as a minimum – for CIC view see their Response.

(ii) *for one week after the adjudicator's decision or such longer period as the parties may agree? Yes ☑ No ☐*

Trustee Accounts

CUBATG would, in addition, like to comment on trustee accounts, discussed in Annex A. First, to put the record straight, CUBATG did not agree that *Ferson v Levolux* renders unenforceable agreements that monies be paid into trustee accounts ("trustee account provisions"). Graham Watts' letter to Denis Walker of 10th November 2006 confirms the meeting held on 31st October. The relevant paragraph reads, "The question posed is whether the Group has heard the argument that payment to a trustee is unenforceable in any event, as a result of a Court of Appeal decision in *Ferson v Levolux AT*. The members of the Group said that they had not."

CUBATG has evidence that the incidence of trustee account provisions is increasing dramatically. The problem was highlighted in the March 2005 consultation exercise, and as a result such provisions are being used as a disincentive to parties going to adjudication. Adjudicators therefore do not tend to see contracts containing such provisions, but those advising on contracts and claims do. See the evidence put forward by CIC and SEC Group.

Regarding *Ferson v Levolux*, see the note prepared by TeCSA.

CUBATG is in agreement that the earlier proposals, to render such provisions unenforceable, should be enacted. See the CUBATG Response to the Regulatory Impact Questions concerning adjudication dated June 2005, which said, "Preventing the use of 'trustee stakeholder accounts' would be beneficial but permitting their use in cases where the receiving party is insolvent would not be beneficial."

Annex to CUBATG Response
September 2007

Ferson v Levolux – Possible application of the decision so as to make ineffective a provision giving an adjudicator the power to direct monies to be paid to a trustee stakeholder

The purpose of this note is to clarify CUBATG's position on whether it is likely that the courts would treat an agreement that an adjudicator should have the power to direct that payment which he awards should be made into a trustee account (rather than direct to the other party) as ineffective in view of the Court of Appeal's decision in *Ferson Contractors v Levolux AT*.

This point is raised in Annex A to the Second Consultation Document, *Improving Payment Practices in the Construction Industry*, where it is suggested that such an agreement would indeed be held as ineffective on the basis of that decision and it is also suggested that CUBATG have at some stage agreed with that view.

It is worth setting out the salient facts of the *Ferson v Levolux* case in some detail in order to put the Court of Appeal's unanimous decision into a proper context:

- Ferson engaged Levolux to supply and fit panelling on a project in Bristol;
- Levolux made its second interim payment application in a sum of approximately £50,000 of which Ferson was only prepared to pay approximately £4,000 relying upon a Notice of Withholding in respect of the remainder of the monies applied for;
- Levolux claimed that the payment of the £4,000 was late and it therefore suspended performance of its work on site;
- Ferson reacted by giving Levolux notice of its intention to terminate the contract on the grounds of wrongful suspension unless Levolux resumed its work. Levolux refused and Ferson therefore terminated the contract;
- In the meantime, Levolux had commenced adjudication proceedings in which the Adjudicator held that about £52,000 was due to Levolux *and* that Ferson's Notice of Withholding was invalid;
- Ferson refused to pay and Levolux brought enforcement proceedings in the Technology and Construction Court which came before HHJ Wilcox whose decision in Levolux's favour was the subject of the appeal.

A number of different arguments were advanced on Ferson's behalf in the Court of Appeal all but one of which, it is submitted, can be disregarded in this context.

In summary, in order to defend its decision not to pay Levolux the amount awarded by the Adjudicator, Ferson relied upon a provision in the contract the effect of which was that, once it had terminated the contract, any obligation which it had to pay outstanding monies to Levolux automatically ceased to apply.

Ferson's argued that recent case law suggested that in any situation where there is a conflict between the requirement to pay an adjudicator's award and clear provisions contained elsewhere in the contract, it does not by any means necessarily follow that the requirement to meet the adjudicator's award should prevail.

In this case, the relevant conflicting provisions were as follows. Firstly, clause 38A.9 of the Contract provided that:

> *"Notwithstanding clause 38B [the arbitration clause], the Contractor and the Sub-Contractor shall comply forthwith with any decision of the adjudicator; and shall submit to summary judgment/decree and enforcement in respect of all such decisions."*

Conversely, and this was the provision upon which Ferson relied, clause 29.8 provided that:

> "*If the Contractor shall determine the Sub-Contract by any reason mentioned in Clause 29.6 (including wrongful suspension of works)…All sums of money that may then be due or accruing either from the Contractor to the Sub-Contractor will cease to be due or to accrue due."*

The effect of Clause 29.8, so Ferson argued, was to override the requirement to honour the Adjudicator's award comprised in clause 38A.9.

In reaching its decision, the Court of Appeal looked closely at Ferson's submission that recent case law supported the above proposition Mantell LJ, who delivered the leading judgment, closely examined the particular decision upon which Ferson relied, namely HHJ Thornton's decision in *Bovis Lend Lease v Triangle Developments* in which he had commented that one of the exceptions to the principle that an adjudicator's decision is binding and enforceable pending final resolution in arbitration or litigation is:

> "*where other contractual terms clearly have the effect of superseding, or provide for an entitlement to avoid or deduct from a payment directed to be paid by an adjudicator's decision, [in which case] those terms will prevail."*

For present purposes, it is unnecessary to examine in any detail either the *Bovis Lend Lease v Triangle* decision, or the Court of Appeal's comments on it, in *Ferson v Levolux*. Having examined the authorities which had influenced HHJ Thornton's to reach that conclusion, Mantell LJ in *Ferson v Levolux* made it clear that he did not consider that the Judge's conclusion represented good law.

However, Mantell LJ considered anyway that the answer to the appeal was the straightforward one adopted by HHJ Wilcox at first instance which was in his words:

> "*The intended purpose of s.108 is plain. It is explained in those cases to which I have referred to an earlier part of this judgment. If Mr Collings and His Honour Judge Thornton are right, that purpose would be defeated. The contract must be constructed so as to give effect to the intention of Parliament rather than to defeat it. If this cannot be achieved by way of construction, then the offending clause must be struck down. I would suggest that it can be done without the need to strike out any particular clause and that is by the means adopted by Judge Wilcox. Clauses 29.8 and 19.9 must be read as not applying to monies due by reason of an adjudicator's decision."*

When one examines the cases to which Mantell LJ refers in the above passage in order to understand what he means as "*the intended purpose of s.108*", the position appears to be as follows:

> "*The intention of Parliament is enacting the Act was plain. It was to introduce a speedy mechanism for settling disputes in Construction contracts as a provisional interim basis and requiring the decision of adjudicators to be enforced pending the final determination of disputes….* (Macob v Morrison)
>
> *"Parliament has made it clear that the decisions of adjudicators are binding and are to be complied with until the dispute is finally resolved."* (Macob v Morrison)
>
> *"The adjudicator's decision, although not finally determinative, may give rise to an immediate payment obligation. That obligation can be enforced by the courts. But the adjudicator's determination is capable of being reopened in subsequent proceedings. It may be looked upon as a method of providing a summary procedure for the enforcement of payment provisionally due under a construction contract."* (Bouygues v Dahl Jensen).
>
> "*The provisions of section 109-111 are designed to enable the contractor to obtain payment of interim payments"* (CB Scene Concept Design v Isobars)

It can be seen that, for the main part, the Courts are in these passages identifying as Parliament's intention in enacting the Construction Act, an intention to introduce a speedy and effective alternative method of resolving disputes in the form of adjudication.

It is easy to see why, on the facts of *Ferson v Levolux*, the Court of Appeal were persuaded that to allow a provision of the sort that Ferson was relying on to override an obligation to comply with an adjudicator's award would indeed undermine the adjudication process and, with it, Parliament's intention as stated above. The simple fact is that, had clause 29.8 prevailed, it would have nullified the adjudicator's decision altogether.

Such a case should be contrasted, it is submitted, with one where there is a clause in the contract which gives the adjudicator the power to direct monies awarded to be paid to a trustee stakeholder rather than to the other party direct. If effective, that provision does not have the effect of undermining the adjudicator's decision. What it does is to permit the adjudicator, in his discretion, to make a particular form of decision which would, in practice, be binding and enforceable in the normal way.

There may be some case on the basis of the decision itself for extending *Ferson v Levolux* in that manner. One of the passages to which Mantell LJ referred as stating Parliament's intention behind the Act, *i.e* that of Sir Murray Stuart-Smith in *CB Scene Concept Design v Isobars,* refers to the purpose of the payment provisions (*i.e.* ss109-111) as being to enable the contractor to obtain payment of interim payments. That purpose would arguably be undermined to some extent were an adjudicator subsequently able to direct that payment to be made to trustee stakeholder rather than direct to the payee.

However, it certainly remains to be seen whether the courts would be prepared to extend the approach underlying *Ferson v Levolux* in that manner.

Finally, there is at least some doubt as to whether the courts would strike down such a provision on that basis. In this context, it should be remembered that the courts will normally stay the enforcement of an adjudicator's decision if there is some evidence of insolvency on the part of the payee. That approach has itself become an important principle surrounding the operation of the legislation. It could be argued that to give the power to the adjudicator to direct payment into a trust account would in fact be highly desirable where the adjudicator suspected there might be a risk of insolvency on the payee's part or he felt there was some other good reason to do so. On that basis, it could be said that such a provision is actually consistent with the principles surrounding the legislation.

In conclusion, there is a real question mark as to whether the courts would strike down a trustee stakeholder provision of this sort on the basis of the decision in *Ferson v Levolux*.

14th September 2007