



CONSTRUCTION CONTRACTS

Payment Terms in Public Contracts: is further statutory intervention required?

On the 25th October 2017 Lord Prior of Brampton announced that as part of its review into the 2011 changes to the Construction Act,¹ the Department for Business, Energy and Industrial Strategy was publishing two consultations on payment practices in the construction sector. The purpose of the consultation was to assess whether and to what extent government intervention may be required in respect of payment practices².

The consultation to support the review coincided with the collapse of the UK's second largest construction company³ and a resultant early day motion ("EDM") tabled by James Firth MP.

"...the collapse of Carillion highlights the payment abuse suffered by sub-contractors engaged in the delivery of public contracts for a Prime contractor; further notes that 30-day payment regulations for public sector contracts are routinely ignored by Prime contractors and left unenforced, which facilitate practices such as Carillion's 126-day payment terms, leaving thousands of SMEs exposed..."⁵

The timing of these events is significant, and will no doubt give rise to consideration regarding what (if any) action the government should take to regulate payment timescales on construction contracts, particularly where the employer is, for the purpose of the Regulations a "Contracting Authority"⁴.

The EDM tabled by James Firth raises concerns over what it calls payment abuse and a failure to comply with and enforce the payment conditions set out in the Public Contract Regulations 2015. It states:

- 1 The Housing Grants, Construction and Regeneration Act 1996 as amended by the provisions of Part 8 of the Local Democracy, Economic Development and Construction Act 2009.
- 2 <http://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Lords/2017-10-24/HLWS194>
- 3 <http://www.theconstructionindex.co.uk/market-data/top-100-construction-companies/2017>
- 4 "Contracting Authorities" means the State, regional or local authorities, bodies governed by public law or associations formed by one or more such authorities or one or more such bodies governed by public law, and includes central government authorities.
- 5 <https://www.parliament.uk/edm/2017-19/840>

The difficulties that such lengthy payment terms may cause to the cash flow of a SME are well documented. These difficulties are further exacerbated when the party that owes the money enters into liquidation. In such cases, companies subject to payment terms of 120 days are exposed to 4 months' worth of revenue. The government consultation recognises that payment practices such as this act as a barrier to investment, productivity, improvement and growth in the sector⁶.

This article looks at the existing legislation governing payment processes in construction contracts and how, if at all, changes to the Regulations or the Construction Act could improve the payment process and reduce the financial exposure of SME's.

The Government Review

The review into the effectiveness of the 2011 changes to the Construction Act is set to consider a number of areas of the Act. It seeks to understand how effective the changes to the Construction Act have been in:

- Increasing transparency in the exchange of information relating to payments;
- Encouraging parties to resolve disputes by adjudication, where appropriate; and
- Strengthening the right to suspend performance.

Whilst none of these objectives go directly to the timing of payments on construction contracts, the review recognises that prompt and fair payment has long been an issue in the construction industry and cites the 30-day payment terms in the Public Contract Regulations as an example of good practice.

As part of a more general set of questions into the overall effectiveness of the Act, the consultation asks the participant to give details of its current and historic average payment days (terms). This is an indication that it is considering whether the Act is efficiently encouraging prompt payment practices.

What the Act says

Whilst the Construction Act provides a party to a construction contract the right to stage payments, the parties are free to agree the intervals at which the payments become due.

Section 110 of the act requires every construction contract to provide an adequate mechanism for determining what payments become due under the contract and when. It also ensures that each contract shall include a final date for payment in relation to any sum that has become due.

It does, however, give the parties freedom to agree the length of the period between the date on which a sum becomes

due and the final date for payment. The only period which is prescribed by the Act is the period between a payment falling due and the giving of notice by the payer setting out the amount of the payment to be made (5 days)⁷.

The use of a standard form construction contract will generally ensure compliance with the payment provisions of the Construction Act. For example, the JCT DB 2016 contract provides for a due date 7 days after the relevant interim valuation date (to be specified by the parties, if not specified then one month after the date of possession and thereafter the same date in each month). The final date for payment of each interim payment shall be 14 days from its due date. Accordingly, if the contractor made monthly interim applications for payment, the final date for payment would be 21 days after receipt by the Employer of the relevant application for payment.

Similar provisions apply in the JCT DB 2016 Subcontract, although they extend the final date for payment to 26 days from the valuation date.

These terms are commonly amended to extend the due date and the final date for payment, such that the final date for payment is often between 45 and 120 days from the relevant valuation date. Such amendments are not a contravention of the Act, however, where they apply to public contracts⁸ they may be contrary to the Public Contract Regulations.

What the Regulations say

Regulation 113 of the Public Contracts Regulations 2015 relates to "Payment of undisputed invoices within 30 days by contracting authorities, contractors and subcontractors." It contains a number of provisions for the prompt payment of contractors, subcontractors and sub-subcontractors alike.

The regulation applies to all public contracts except:

- contracts for the procurement of healthcare services for the NHS that are within the scope of the National Health Service regulations;⁹ and
- contracts awarded by a contracting authority which is a maintained school or Academy.

The Regulations require contracting authorities to ensure that every public contract which they award contains provisions providing for payment to the contractor not later than the end of a period of 30 days from the date on which its invoice is regarded as valid and undisputed.

The Regulations also require that the contract between the contracting authority and the contractor requires that the 30-day payment provisions are stepped down to contracts between the contractor and subcontractor and between the subcontractor and its sub-subcontractors.

⁶ Consultation Executive Summary

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⁸ Defined by the Regulations as "contracts for pecuniary interest concluded in writing between one or more economic operators and one or more contracting authorities and having as their object the execution of works, the supply of products or the provision of services"

⁹ National Health Service (Procurement, Patient Choice and Competition) (No. 2) Regulations 2013(1)

What happens if no such clause is included, or the payment terms are more onerous?

In the event that the requirements to Regulation 113 (1) are absent from the contract, it appears that, in any event, a term will be implied by Regulation 113 (6) requiring payment to be made within 30 days.

This means that even if the payment periods stated in a public contract exceed 30 days, a contractor, subcontractor or sub-subcontractor may still have a statutory right to be paid within 30 days.

How does that work in Construction Contracts?

On 1 September 2016, the government produced a revised guidance note regarding Regulation 113 and how it should be read in conjunction with the payment provisions of construction contracts which rely on notices, rather than invoices, to trigger the payment process.

The revised statutory guidance states that in respect of the 30 day period under construction contracts:

- a) Where the paying party starts the payment process by issuing a Payment Notice the 30-day period commences after the notice is issued.
- b) Where the paying party has failed to issue its notice and the default process applies (i.e. the contractor, subcontractor or sub-subcontractor may issue a notice in default) the 30-day period commences from that date which is the later of, the date when the paying party ought to have issued its notice and the date the notice in default was issued.
- c) Where the Contract provides that the contractor, subcontractor or sub-subcontractor is to provide a notice, the 30-day period commences after service of the notice.

There is, at regulation 113(4) a requirement for contracting authorities to have regard to any guidance issues by the minister for the Cabinet Office.

Next steps

Care has been taken in the current drafting of the Construction Act to ensure that a requirement to provide transparency on the timing and amounts due under the payment process does not restrict the parties' rights to agree the intervals at which interim payments will become due.

Given the widespread observation of the Construction Act within the industry, and the recent criticism the government has come under for failing to enforce the Public Contract Regulations, it may consider incorporating the requirements of Regulation 113 of the PCR's into the Construction Act. Public Contracts may then be subject to a restriction as to the amount of time that may pass between the due date and the final date for payment.

Including such provisions within the Act may also have the added benefit of self-regulation and enforcement with aggrieved parties able to refer a dispute regarding payment terms to adjudication.

With all of the above said, there are a number of alternative methods by which the government may improve its adoption of the 30-day payment terms in the PCR's. It therefore remains to be seen if recent events will give rise to further changes to the payment provisions of the construction legislation.

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