THE CONSTRUCTION CONTRACTS ACT, 2013:

IMPROVING CASH FLOW WITHIN THE CONSTRUCTION INDUSTRY AND THE INTRODUCTION OF STATUTORY ADJUDICATION

JENNIFER O'CONNELL BL

1. Background

As a consequence of the banking and property market collapse, the Irish construction industry experienced unprecedented financial difficulties and liquidity problems. In 2009, the economy was experiencing almost ten construction industry failures per week,[1] a trend which was compounded by the widespread practice of late payment and underpayment of contractors and subcontractors.

In an attempt to improve cash flow and to alleviate the problems being experienced by companies within the industry, Senator Fergal Quinn introduced a private members bill in the Senate, the first to be presented to the Oireachtas in over 50 years. When introducing the legislation in May 2010, Senator Quinn stated that his intention was to introduce legislation which would bring transparency and certainty to payment provisions in construction contracts and to provide a speedy and cost effective dispute resolution process.[2]

The Bill was described in its explanatory memorandum as being, *"in ease of persons along the chain in the construction sector who may suffer unduly where an entity under a superior contract would find itself withholding payments unilaterally without cause"*.[3]

When moving the second stage of the Bill on the 3rd May, 2012, Minister for State, Brian Hayes, TD, remarked as follows:

> *"While there is strong anecdotal evidence of the practice of delayed or non-payment having escalated in recent times, it should be noted that the problem is not new. It is reported that many firms, mainly*

[1] Cunningham T. (2013), *Will the Construction Contracts Bill Improve Subcontractor Cash Flow? Dublin Institute of Technology*, Dublin Institute of Technology
[2] Oireachtas (2010)
[3] Explanatory Memorandum, Construction Contacts Bill, 2010 (March 2011)

subcontractors, are experiencing serious difficulty in obtaining payment for work done. It is therefore important that where possible all payment transactions within the sector should be facilitated to ensure prompt payment of the correct amount". [4]

Following consultation between government departments and the industry, the legislation aimed to achieve a more equal balance by introducing statutory requirements regarding payments, and providing for adjudication as a quicker mechanism for resolving payment disputes.

2. The Construction Contracts Act, 2013

The Construction Contracts Act, 2013, was enacted by Dáil Eireann on the 29th July, 2013, over three years after Senator Quinn initiated the legislation. The Act awaits a commencement order and it is anticipated that the Minister for Public Expenditure and Reform ("the Minister") will aim to fulfil two further requirements before bringing the legislation into force, namely; (1) the nomination of a panel of adjudicators, and (2) the publication and passing of the Code of Practice for Adjudicators.

The Act is relatively brief, extending to only 12 sections, which can be summarised as follows:

Sections 1-2: Define the types of contracts which fall within the legislation;

Sections 3-5: Sets forth the mandatory payment provisions to be included in all construction contracts and the consequences of failure to pay;

Section 6: Introduces the new statutory adjudication procedure;

Section 7: Provides for a right to suspend works for failure to comply with an adjudicator's award;

Section 8: Provides for the panel of adjudicators to be appointed by the Minister;

Section 9: Provides for the Code of Practice for adjudicators to be published by the Minister;

[4] Oireachtas (2012)

Section 10: Provides for notice provisions and the time for delivery of same;

Section 11-12 Deals with the expenses of implementing the provisions of the Act and its commencement.

3. Application of the Act – Sections 1 and 2

The term *"construction contract"* is widely defined in the Act as applying to:

1. The carrying out of construction operations;

2. Arranging for the carrying out of construction operations; and

3. Providing labour for the carrying out of construction operations.[5]

"Construction operations" are also broadly defined as any activity associated with construction, including specialist works contracts, cleaning operations, preparatory work, decoration work and individual craftsman contracts.[6] Guidance can be drawn from the United Kingdom, where the equivalent legislation (i.e. The Housing Grants Construction Regeneration Act of 1996, as amended by the Local Democracy Economic Development and Construction Act, 2009) provides an almost identical definition of construction operations.

The Act specifically provides that consultant contracts are covered,[7] whereas supply only contracts are excluded. It was debated extensively at the Bill stage whether supply only contracts should be included but the rationale behind their ultimate exclusion was that such contracts are already covered by existing legislation.

Early drafts of the Bill provided that the legislation would apply only to private contracts with a value in excess of €200,000 and public contracts with a value in excess of €50,000. Ultimately, the thresholds were considered to be too high and as a result the earlier thresholds have been replaced with a single threshold of €10,000, which makes no distinction between public and private contracts.[8] It should be noted that while the threshold applies to contracts valued at less than €10,000, it does not

[5] s. 1(1) of the Construction Contracts Act 2013 ("the 2013 Act")
[6] s. 1(1) of the 2013 Act
[7] s. 2 of the 2013 Act
[8] s. 2(1) of the 2013 Act

apply to claims valued at less than €10,000, although it is as yet to see how this distinction will be applied when the Act comes into force.

Owner occupied dwelling houses of less than 200 square meters are excluded from the Act, as are Contracts of Employment.[9] There is a specific exclusion for public private partnerships ("PPP"),[10] but it is considered that main contracts and subcontracts arising under PPP arrangements are not excluded.

It is very significant that a party cannot opt out of the legislation and therefore if a contract falls within its ambit, the provisions of the Act automatically apply. If a contract fails to conform to the legislation, the provisions of the Act are automatically incorporated. Alternatively, if the contract includes provisions that conflict with the Act, the Act will take precedence.[11] This inability to contract out of the provisions of the Act is a central feature of the legislation.

4. Mandatory Payment Provisions – Sections 3 - 5

The Act requires that all construction contracts to which it applies include; (i) an adequate mechanism for determining the amount to be paid to a contractor, (ii) the period for inter payments, and (iii) the period when payments will fall due.

Section 3 of the Act provides that payment provisions must:

1. Identify either the amount of each interim payment and the final payment to be made under the contract, or provide an *"adequate mechanism"* to establish these sums; and

2. Identify either the payment claim dates or an *"adequate mechanism"* to determine these and stipulates the maximum period within which these payments must be made.

Where a contract does not include the required provisions referred to above, the Schedule to the Act will apply. The Schedule provides that payment claim dates under a construction contract will be 30 days after the commencement of the contract and at 30 day intervals thereafter, until substantial completion is achieved. The final

[9] s. 2(2) of the 2013 Act
[10] s. 2(3) of the 2013 Act
[11] s. 2(5) (a) and (b) of the 2013 Act

payment claim date arises 30 days following final completion.[12] On short duration contracts not exceeding 45 days, the payment claim date is to be 14 days following completion of the work.[13] Payments become due 30 days after the payment claim date.[14]

In the event that the contract does not contain *"adequate mechanisms"* for identifying the amount due or the timeframe for payment, the legislation imposes a mechanism for making these determinations. The Act differentiates between main contracts and subcontracts in this context, as the legislation allows for employers to agree/impose periods of time for paying the main contractor which exceed those noted in the schedule, whereas with subcontractors, the periods for payment are to be considered as maximum periods and the parties are only free to agree a shorter timeframe than that noted in the Act.

5. Payment Claim Notice – Section 4

The Act introduces an entirely new concept in the form of *"payment claim notice"*, the purpose of which is to provide sufficient information so that a party can understand why any payment is being sought. The idea is that when the recipient has this information, a decision can be reached on whether the money is due or, alternatively the information can be used to provide, in turn, a detailed explanation as to why that money is not due.

The Act requires that a valid payment claim notice must contain the following:

(a) Details of the amount being sought;

(b) The period, stage or activity to which the payment relates;

(c) The *"subject matter"* of the claim; and

(d) The basis on which the amount sought has been calculated.[15]

To be valid, the payment claim notice must be issued within 5 days after the payment claim date. [16]

[12] s.1 of the Schedule to the 2013 Act
[13] s. 2 of the Schedule to the 2013 Act
[14] s. 3 of the Schedule to the 2013 Act
[15] s. 4(2) of the 2013 Act.

Once a payment claim notice has issued, the onus then switches to the employer. The paying party must consider the payment claim notice and decide whether they intend to discharge the full amount claimed or to contest any of the amounts claimed. If the employer decides to contest the sum claimed or any part thereof, it must issue a *"withholding notice"*. For a withholding notice to be valid, it must adhere to the following:

(a) It must be issued not later than 21 days after the payment claim date;

(b) It must identify how much it is proposed will be paid (even if that is a zero figure) and explain the basis for calculating that amount. Any amount that is admitted to be due must be paid by the payment due date;

(c) It must provide reasons for any difference between the amount to be paid and the amount claimed;

(d) Where reasons are provided, (e.g. claim for breach of contract) the withholding notice must provide details as to when the loss and damage occurred, particulars thereof and a breakdown of the loss and damage as against any particular item claimed.[17]

The Act is silent on the consequences of any failure to issue a timely and compliant withholding notice and therefore, it is not clear whether the party seeking payment is entitled to payment in full of the amount claimed in default of same. Where a compliant withholding notice has been served and the parties cannot agree the payment amount by the payment due date, the employer must pay the amount stated in the withholding notice, while retaining the right to refer the dispute to adjudication.

6. Pay When Paid Clauses – Section 3(5)

There has been a longstanding practice within the construction industry that a sub-contractor's payment was made conditional upon payment being received by the contractor from the employer. This condition, traditionally referred to as a "*pay when*

[16] S. 4(1) of the 2013 Act
[17] s. 4(3) of the 2013 Act

paid" clause, resulted in significant hardship for sub-contractors and reflected the unequal bargaining power which the legislation has sought to address.

The Act introduces a significant change by prohibiting *"pay when paid"* clauses, save where one of the parties to the contract is in an insolvency process. [18] Where a contract attempts to make a payment conditional on the actions of a third party, such provision is deemed ineffective. Whether clauses which provide for *"pay when certified"* provisions are acceptable, on the current wording, it is considered likely they will be permitted, assuming the contract has been drafted appropriately.

7. Suspension for Non-Payment – Section 5

A very significant statutory entitlement has been introduced with the right to suspend works for non-payment. This allows a contractor who has not been paid by the due date to suspend work, provided a written notice has been provided to the employer at least 7 days before suspension is to take effect, specifying the grounds upon which the suspension is proposed. [19]

The Act provides that the period of suspension of work for non-payment will be disregarded for the purposes of the construction programme. The period of suspension will also be discounted for any other contractors involved in the project, whose works may be affected by the suspension of the other party.

The suspension will not be allowed to continue once the dispute related payment has been referred to adjudication. This has the potential to dilute the effect of a threat of suspension of works and would also mean that a subcontractor would have to continue works whilst the adjudication process was underway.

8. Referring Payment Disputes to Adjudication – Section 6

The Act provides that any party to a constructing contract may refer to adjudication, *"any dispute relating to payment under the construction contract"*.[20] Unlike the UK, where all disputes arising out of construction contracts may be referred to

[18] s. 3(5) and (6) of the 2013 Act
[19] s. 5(1) and (2) of the 2013 Act
[20] s. 6(1) of the 2013 Act

adjudication, the Act only allows for the referral of *"payment disputes"*. [21] While we have adopted a narrower definition in this jurisdiction, almost all construction disputes relate in some way to payments and therefore, any perceived restriction may be circumvented by presenting the claim in a way that it can be characterised as a payment dispute. In practice, it is anticipated that claims *"relating to payment"* will encompass most disputes that arise, including disputes relating to delays, extensions of time and defects. However, there will no doubt be some debate as to whether disputes *"relating to payment"* will also encompass disputes where particular forms of declaratory relief are sought.

(i) Procedure

Adjudication is commenced by way of service of a notice by one party on another *"at any time"* of the intention to refer that particular payment dispute to adjudication.[22] The words *"at any time"* are significant and were relied on in the recent decision of the UK Technology and Construction Court (TCC), in *Willmott Dickson Housing Limited –v- Newlon Housing Trust* [2013] All ER (D) 42 (Apr), where it was held that as the UK legislation also allows for the referral of disputes to adjudication *"at any time",* there was nothing to prevent two separate disputes being referred to adjudication at the same time.

The significance of a party being in a position to refer a dispute to adjudication at any time is that if the parties have agreed a multi-tiered dispute resolution process, which may include conciliation, mediation, adjudication and then arbitration, either party retains the right to proceed to adjudication at any stage in the process. Therefore, if the parties are in the throes of having the matter resolved by way of mediation, either party can commence fresh adjudication proceedings without any regard to the mediation already in train.

Within 5 days of either party having served a notice of intention to refer a payment dispute to adjudication, the parties must agree to appoint either an adjudicator of their own choice, or one from the panel appointed by the Minister.[23] Failing agreement

[21] n. 16
[22] s. 6(2) of the 2013 Act
[23] s. 6(3) of the 2013 Act

between the parties, the adjudicator will be appointed by the chair of the panel selected by the Minister. [24]

The party who served the notice is required to refer the dispute to the adjudicator within 7 days of his appointment and the adjudicator is required to make a decision within 28 days beginning on the day on which the referral is made, or such longer period as is agreed between the parties.[25] The adjudicator may extend the 28 day period by up to 14 further days with the consent of the party that referred the dispute.[26]

While the Act allows for the extension of the period within which the adjudicator must make his decision, it appears to be the intention of the legislation that such extension be the exception, rather than the rule. The experience in the UK would indicate that speed is an essential characteristic of the statutory process.

The strict and tight timeframes which are triggered by the service of a notice to refer a dispute to adjudication can give rise to the possibility of what have been referred to as "ambush" situations, where one of the parties prepares its case in advance of referral. The experience in the UK suggests that the threat of such abuse has been managed by experienced adjudicators using the threat of withdrawal as a means of ensuring that fair procedures are observed and extensions agreed between the parties if so required.

(ii) Challenging the Adjudicator's Decision

An adjudicator's decision is binding and may only be overturned by agreement between the parties or by subsequent determination of the Court or an arbitrator, depending on the dispute resolution procedure within the particular construction contract.[27] Once an adjudicator has made his decision, it becomes immediately enforceable and typically will require that one of the parties will have to pay a sum of money to the other. If the award is not discharged, the adjudicator's decision will be capable of summary enforcement in the same way as any court order. As a consequence, adjudication is a powerful dispute resolution tool and the adjudicator's

[24] s. 6(4) of the 2013 Act
[25] s. 6 (6) of the 2013 Act
[26] s. 6(7) of the 2013 Act
[27] s. 6(10) of the 2013 Act

decision can only be overturned by an arbitrator's award or a Court order, both of which are lengthy processes.

The UK judiciary had been very strict on challenges to an adjudicator's award and consider it binding and capable of enforcement, except in certain very limited circumstances. The judiciary in that jurisdiction have shown their support for the process and it is evident that the Courts are reluctant to undermine the integrity of the adjudication procedure. Challenges will typically arise out of allegations of excessive jurisdiction or a failure to comply with the principles of natural justice. Similar to the language of the UK Scheme for Construction Contracts, the Act requires that an adjudicator act impartially in the conduct of the adjudication and there is also reference to adhering to the Code of Practice to be published by the Minister, as seen in s.6(8) of the Act. It is assumed that the Code of Practice will reiterate the obligation on an adjudicator to comply with the principles of natural justice and impartiality.

If a decision is to be challenged on the basis of a breach of natural justice, case law from the UK indicates that this breach must be substantive and material. In the TCC decision of *Herbosh Kiere-Marine Contractors –v- Dover Harbour Board* [2012] EWHC 84, Aikenhead J. found that the adjudicator had made his decision and award on the basis of a method of assessment which neither party had suggested and in respect of which method he had not sought submissions from the parties. The Court determined that the adjudicator had gone off *"on a frolic of his own"* and in the circumstances, the challenge succeeded.

Similarly, in the case of *ABB Limited –v- Baum Nuttall Limited* [2013] EWHC 1963, the TCC held that there was a breach of the principles of natural justice where an adjudicator failed to give the parties an opportunity to make submissions on a particular clause of a contract upon which the Adjudicator relied upon to determine the dispute before him. Neither party had referred to the clause in their submissions, and the adjudicator had failed to make it clear that it was this clause he would be relying upon to determine the dispute. Where the adjudicator did not request submissions from the parties on this issue, the challenge to his decision was successful.

While the Act specifically allows an adjudicator to *"take the initiative"* in ascertaining the facts and the law in relation to the payment dispute,[28] it seems clear that if he is going to take the initiative, that he must do so very carefully and invite submissions if he intends to take a novel approach to any issue referred.

An adjudicator is allowed to deal with several payment disputes arising under the same construction contract or related construction contracts.[29] The phrase *"related construction contracts"* does not appear in the equivalent UK legislation and it is presumed that it is intended to refer to related construction contracts between the same parties, although this is not expressly stated. It is clearly in the interests of time and cost efficiency that the same adjudicator can, if appropriate, deal with different disputes arising from the same works referred under different notices. However, it should be noted that once an adjudicator has disposed of a dispute and issued a decision, it is not open to him to revisit that decision in any way. An adjudicator's award is binding and the only way it which it can be revisited or set aside is by means of a successful challenge. It would certainly be in excess of an adjudicator's decision if he sought in a subsequent adjudication to either alter, change or amend a previous decision. (See *Vertasse SLI Limited –v- Squibb Group Limited* [2012] EWHC 2194.)

The adjudicator's decision will have no persuasive authority in any subsequent litigation of the underlying dispute, although its existence will not be kept confidential. The decision of an adjudicator will also not be binding on any subsequent adjudicator dealing with a dispute under the same construction contract. In the UK, there is nothing that precludes a subsequent adjudicator from having regard to or reviewing the terms of a decision made by an earlier adjudicator. The essential point is that the second adjudicator is required to determine the decision himself based on the submissions made to him and the earlier decision is not in any way binding upon him. In *Arcadis UK Limited –v- Maye & Baker Limited* [2013] EWHC 87, the challenge was based on the fact that the second adjudicator had sight of the first adjudication decision. The TCC found that where the second adjudicator had carried out his own assessment of the dispute and the facts surrounding it, there was no issue with him having seen the earlier decision and indicating that he was in agreement with the conclusions reached by the first adjudicator.

[28] s. 6(9) of the 2013 Act
[29] n. 24

(iii) Costs

An important feature of the adjudication process is that the parties will pay their own legal and other costs in connection with the adjudication, and that the adjudicator's costs and fees will be discharged in accordance with directions issued by the adjudicator as part of his decision.[30] The adjudicator is not allowed to interfere with the back to back arrangement in respect of the parties' own costs, regardless of his decision. As a consequence, there are low cost risks in engaging in the adjudication process, which undoubtedly makes it more attractive to parties to resolve their disputes.

(iv) Removal of an Adjudicator

If an adjudicator is removed or resigns his position, regardless of when or why this occurs, the parties remain jointly and severally responsible for his fees.[31] It would appear that there is no sanction that can be imposed for failures on the part of the adjudicator to perform his functions and it would appear that an adjudicator is entitled to payment notwithstanding any failure.

In the UK, the equivalent legislation provides that the parties will not be required to discharge the fees due to the adjudicator, where the appointment of that adjudicator was terminated on foot of a misconduct or failure. In *PC Harrington Limited –v- Systech International Limited* [2012] EWCA Civ 1371, one of the determinations made by the Court of Appeal was that the contract with the adjudicator for an enforceable decision failed where no such decision was provided, albeit inadvertently. As a consequence, it was determined that the adjudicator was not entitled to be paid. While the Irish legislation does not provide for any circumstances within which the adjudicator will not be entitled to payment, it remains to be seen whether the Irish courts determine this situation in a similar manner.

It should be noted that in the UK, an adjudicator's entitlement to withdraw from an adjudication has proved to be a very useful tool in persuading the parties to compromise on procedural issues within the adjudication process. If, for example, an adjudicator were to decide that he/she required further time to deliver a decision,

[30] s. 6(15) and (16) of the 2013 Act
[31] s. 6(17) of the 2013 Act

particularly where an ambush situation had arisen, an adjudicator could threaten withdrawal on the basis that fair procedures could not be observed, unless the parties agreed to an extended decision making period. The threat of resignation, we are told, has been a very useful tool in persuading the parties to be reasonable.

9. Panel of Adjudicators and Code of Practice – Sections 8 and 9

The Act provides for the appointment of a Panel of Adjudicators and the publication of a Code of Practice for adjudicators.[32] It is anticipated that the panel will be drawn from professionals from within the construction industry with experience in construction dispute resolution. It is understood that the Code of Practice will take the form of a statutory instrument and that the drafting of this Code is at an advanced stage. It is unlikely that a commencement order will be introduced before the Panel of Adjudicators is appointed and the Code of Practice has been published. The United Kingdom has a substantive and detailed document which provides guidelines for adjudicators and practitioners alike entitled The Scheme for Construction Contracts, and undoubtedly the Irish Code of Practice for adjudicators will be developed along similar lines.

While an adjudicator is not required to provide reasons for his decision, experience in the UK is that for the most part, adjudicators do provide reasons for decisions. This enables the parties to understand the rationale behind decisions and undoubtedly this practice has contributed to the success of adjudication in that jurisdiction.

10. Conclusion

The UK construction industry has embraced the statutory adjudication process and in the majority of cases, the findings and determinations which have issued, typically amount to the final stages of a dispute. As a consequence, the construction industry has adopted the statutory adjudication process as its forum of choice for dispute resolution, where it is described as arbitration without discovery.

The UK process has been successfully supported by the courts, and in particular the TCC. Where we do not have a specialist construction court available to hear

[32] ss. 8(1) and 9 of the 2013 Act

challenges to adjudicator's decisions, consideration should be given to the nomination of a specialist judge in this jurisdiction to support the process.

While the purpose of the adjudication procedure is to ensure cost efficiencies, the complexity of the procedural objections raised in the UK have resulted in the involvement of legal representatives in the process. There have been a significant number of decisions issued by the TCC on various aspects of the adjudication procedure and this testifies to the complexity and technicality of the process.

The Construction Contracts Act 2013 has been broadly welcomed by the construction industry and it is hoped by providing mechanisms for payment and by protecting cash flow, this will ensure the survival of the remaining players within the industry and assist with recovery.

Jennifer O'Connell BL

23, November, 2013