



**IMPROVING PAYMENT
PRACTICES IN THE
CONSTRUCTION INDUSTRY**

Analysis of the consultation on proposals to amend Part II of the Housing Grants Construction and Regeneration Act 1996 and Scheme for Construction Contracts (England and Wales) Regulations 1998

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Llywodraeth Cynulliad Cymru
Welsh Assembly Government

Improving payment practices in the construction industry – Analysis of the consultation on proposals to amend Part II of the Housing Grants Construction and Regeneration Act 1996 and Scheme for Construction Contracts (England and Wales) Regulations 1998

Explanation of the wider context for the consultation

The Department of Trade and Industry and Welsh Assembly Government's consultation document was issued on 22 March 2005.

The consultation proposals were made in response to Sir Michael Latham's review of the operation of Part II of the Housing Grants, Construction and Regeneration Act 1996 (the Construction Act), and the Scheme for Construction Contracts (England & Wales) Regulations 1998 (the Scheme). This review, announced in the 2004 Budget, was published in September 2004.

The consultation closed on 21 June 2005. In total 356 responses were submitted. This document summarises the responses we received. The document also outlines the Government's proposals in the light of those responses and announces the Government's planned next steps towards amending the legislation.

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Confidentiality

Responses to the consultation have all been made public by the DTI and Welsh Assembly Government unless respondents specifically asked that their response or identity remained confidential. The responses are available at:

http://www.dti.gov.uk/construction/hgcra/consult_resp.htm

We have handled any personal data provided by respondents as is appropriate in line with the Data Protection Act 1998.

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Foreword

**By Rt Hon Alun Michael MP,
Minister of State for Industry and the Regions
and Edwina Hart AM MBE, Welsh Assembly Minister
for Social Justice and Regeneration**

In March 2005 we sought your views on *Improving Payment Practices in the Construction Industry*.

We are very grateful to all those who responded and who participated in the consultation events and welcome the strong support that the consultation has demonstrated for continued regulation of construction contracts and the process of improving the current framework. In total 356 responses were received.

As well as analysing the consultation responses, this document sets out the proposals we now intend to take forward as amendments to the legislation for further consultation. It also indicates the next steps we intend to take to ensure the consultation package is the right one and is based upon a clear and thorough understanding of all the issues.

The aim is to improve upon the existing framework, which it is clear is generally recognised as making a valuable contribution to fairness in the way construction contracts are agreed and operated. It seems clear that the legislation is largely working as was intended, thanks in part to its effective implementation by adjudicators and the courts and to the willingness of the construction industry and its clients to develop culturally in the light of a changed legal framework.

However, in the wake of the consultation it seems clear there are procedural and commercial obstacles currently affecting the construction market in the operation of contracts under the legislation. The consultation raised difficult and complex issues, which have required careful analysis and innovative solutions. Some elements of the package offer more to certain sectors than others. There is sometimes no easy answer but developing consensus within the construction industry and its stakeholders remains a realistic aim to improve certainty in the payment and adjudication framework. Overall our aim remains to improve the current payment situation in the construction industry for all concerned.



Executive summary

Payment Framework

Our analysis of consultation has concluded:

1. The requirement for an adequate payment mechanism in Section 110(1) of the Construction Act does require further definition
2. There is a strong case for removing the requirement to serve a section 110(2) Notice in the Construction Act
3. There is a case for providing for an application for payment in the legislation in some form
4. It is not necessary to redefine the content of withholding notices under Section 111
5. There is a case for restricting the use of pay-when-certified clauses

Having examined our options we are considering:

- introducing a requirement that certification of the sum due, by one of the contracting parties or a third party, becomes an essential feature of the adequate payment mechanism;
- removing the section 110(2) requirement for a payer notice;
- introducing a right to apply for payment where a certificate is not issued by the due date.

This would be drafted so that certificates issued by a third party under another contract could not be considered to state the sum due under the contract in question. Payment mechanisms including pay-when-certified clauses would then be inadequate. We are also considering whether it is possible to make all pay-when-certified clauses ineffective, though this brings with it a number of difficulties.

Other payment proposals

6. There is clear support for introducing a right to reimbursement for the costs of suspension and remobilisation under section 112 of the Construction Act and for allowing an extension of time for remobilisation
7. There is a case for making contractual provisions on cross contract set-off ineffective, though there are a number of difficulties with this proposal
8. There is support, though few new arguments for making “pay-when-paid” clauses ineffective in cases of upstream insolvency proceedings
9. There is limited support and some argument against allowing stage payments under the Scheme to be made for materials in advance of their arrival on site

We are therefore proposing to enhance the existing right of suspension under the Construction Act. The proposal would allow the suspending party to claim for loss and expense when exercising the existing right, including for the additional costs of remobilisation when and if payment is made. It would also provide the right to an appropriate delay in remobilisation. We do not intend to amend the legislation in any other area under this heading.

Adjudication proposals

10. There is support for preventing the use of “trustee stakeholder accounts” to suspend an adjudicator’s award pending final decision of the dispute at litigation
11. There is little justification for providing the adjudicator with the power to rule on certain aspects of his own jurisdiction. However there is a case for providing the adjudicator with a right to payment in cases where he stands down due to lack of jurisdiction
12. There is a case for providing the adjudicator with the right to open up “final and conclusive” decisions where these are of substance to interim payments only
13. There is some support for extending the adjudicator’s immunity to claims by third parties but other respondents raised persuasive arguments to the contrary
14. There is support, though no clear case for applying provisions on adjudicator independence from the Scheme to all adjudications

We are therefore considering proposals that improve the adjudication process by:

- providing the right to payment to adjudicators upon resignation in response to a challenge to jurisdiction;
- prohibiting the use of trustee stakeholder accounts for awards made by adjudicators;
- making “final and conclusive” clauses unenforceable where they apply to decisions under the contract that are of substance to interim payments only.

We are also taking forward the Government’s existing commitment to make contractual agreements on adjudication costs unenforceable and to provide a statutory framework for allocating these costs.

Introduction

Improving Payment Practices in the Construction Industry considered proposals to amend the Construction Act and the Scheme in three key areas:

- Improving the ability of parties to a construction contract to reach agreement on what should be paid and when given the work done under the contract or, where they cannot agree, to make an informed referral to, or response at, adjudication.
- Improving the ability of the parties to a construction contract to manage cash flow and enable completion of work on the project in the event that problems arise for reasons outside of their control such as defaulted payments, or disputes or insolvencies elsewhere in the supply chain.
- Reducing the disincentives to referring disputes to adjudication where it is suitable. These might include avoidance or frustration of the process or outcome, unnecessary legal challenge or excessive costs.

Consultees were asked:

- whether the right issues had been identified;
- whether the right solutions had been proposed or whether there were other options;
- how we might evaluate the potential costs and benefits of the different proposals.

The response to the consultation was considerable with 356 responses from individuals, firms and representative organisations.

In considering the responses we have kept in mind:

- the need for improvement in payment practices under the legislation for all concerned;
- the need to respect the principle of freedom of contract, though at times it may be essential to intervene;
- the possibility of guidance to address certain issues as an alternative to regulation; and,
- the continuing development of case-law on adjudication and the payment provisions of the Construction Act.

The Way Forward

Having analysed the consultation responses and examined our options we are now considering what changes to the Construction Act and Scheme are needed to:

- Improve the contractual payment framework;
- Enhance the existing right of suspension; and,
- Increase access to the adjudication process.

We are also considering whether it is possible to make all pay-when-certified clauses ineffective, though this brings with it a number of difficulties.

Implementation

We are proceeding on the basis that the most likely method of implementing changes to the construction contracts legislation in England and Wales is a DTI Regulatory Reform Order (RRO).

This will require that:

- The package should remove or reduce a regulatory burden on those affected by the existing legislation;
- Measures within the package that apply regulatory burdens should do so in a way that is proportionate to the benefit realised as a result of the improvement made;
- The package as a whole should strike a fair balance between the benefits realised overall and the new burdens affecting specific groups;
- An RRO is desirable given the extent to which it would relieve the overall burden of the legislation in terms of relieving regulatory burdens and improving it more generally;
- The package should not remove any necessary protection; and,
- The package should not prevent any person from continuing to exercise any right or freedom which he might reasonably expect to continue to exercise.

These tests must be passed if the package is to be acceptable for introduction by Order under the Regulatory Reform Act 2001, but they also provide a useful route to identifying the regulatory impact of the measures irrespective of how they might eventually be introduced.

The consultation responses provided some useful data on the impacts of the proposed changes. This is included in Annex 4 with the other data provided by respondents who completed the consultation response form.

Next steps – Future timetable

As part of the statutory procedure required under the Regulatory Reform Act 2001 we hope to publish a consultation paper on amendments to the legislation in the Spring of 2006. This consultation would then be completed and conclusions drawn in Summer 2006 in time for the 2006-07 parliamentary session.

DTI is taking forward a process of informal discussion with the construction industry on the above proposals. To do this we are involving a sounding board of individuals whose knowledge, experience and access to industry networks will be invaluable as we consider specific amendments to the legislation. The sounding board members are:

- Richard Bayfield
- Chris Dancaster
- Richard Haryott
- Sir Michael Latham
- His Honour Humphrey LLOYD QC
- Peter Rogers

The sounding board members are not intended to represent specific sectors within the construction industry. The DTI will identify opportunities for dialogue between the industry and its stakeholders and the sounding board and the Department during the run-up to the next consultation.

Other Issues – Guidance

In the light of responses received we do not intend to amend the Construction Act to:

- make contractual provisions on cross contract set-off ineffective;
- make “pay-when-paid clauses ineffective in cases of “upstream” insolvency proceedings”;
- allow stage payments under the Scheme to be made for materials in advance of their arrival on site;
- provide the adjudicator with the right to make binding decisions as to his jurisdiction;
- extend an adjudicator’s immunity to claims by third parties;
- apply provisions in the Scheme on adjudicator independence to all adjudications.

We consider that these issues are better suited to guidance. In the course of this analysis, we have identified a number of other areas where guidance would be of value. While guidance to adjudicators is well maintained by the Construction Umbrella Bodies Adjudication Task Group, guidance on payment may be more appropriate for leading industry bodies such as Constructing Excellence.

Chapter I – Payment Framework

Improving the ability of the parties to a construction contract to reach agreement on what should be paid and when given the work done under the contract or, where they cannot agree, to make an informed referral to, or response at, adjudication.

The consultation proposals

We consulted on five proposals under this heading:

1. Defining the content of an adequate payment mechanism in Section 110(1) of the Construction Act
2. Removing the requirement to serve a section 110(2) Notice in the Construction Act
3. Providing an application for payment in the legislation
4. Redefining the content of withholding notices under Section 111
5. Restricting the use of pay-when-certified clauses

The responses

- 1. The requirement for an adequate payment mechanism in Section 110(1) of the Construction Act does require further definition**
 - 1.1 The responses supported our concern about the failure of many contractual mechanisms to bring about effective communication of what sums are due and when. However a more fundamental point was made by large numbers of respondents. In many cases it would appear that construction contracts fail to provide for a mechanism that identifies with sufficient certainty what payments are due under the contract and when.
 - 1.2 Our proposal placed particular emphasis on communication of the sum due but the need for the mechanism to make sure a specific sum can be considered by the parties to be due in the first place concerns us more. Beyond achieving this objective we will wish to bear in mind concerns raised by some respondents about any excessive shift in the proposal towards a prescriptive approach in Section 110(1).

2. There is a strong case for removing the requirement to serve a section 110(2) Notice in the Construction Act

- 2.1 Respondents reported that the section 110(2) notice requirement is ineffective, frequently ignored in the operation of the contract and an excessively burdensome means of communication of the payment to be made. Some respondents believed that the notice should be retained in spite of its limitations as a means of ensuring the contract secured a communicable payment. We have sympathy with the concerns about the role of the notice as a tool of communication. However we disagree with those who see the role of the notice as determining what sums are due. This is the purpose of the adequate mechanism in section 110(1). The section 110(2) notice simply responds to what is due under the contract.
- 2.2 Other respondents were concerned that a payment notice would be necessary in the context of our other proposals. We do not consider this will be the case where a contractual mechanism functions as intended so that the sum due is clear to both parties on the due date.
- 2.3 As well as proposing to remove the requirement, we proposed to remove the concept of a “due date” from the legislation in favour of an “assessment date”. Generally respondents sympathised with the view that the term “due date” was misleading if interpreted as providing that the sum due under the contract becomes payable when it becomes due. In fact the sum due is subject to withholding and the amount remaining is not payable until the final date for payment. Other respondents recognised this and considered this practice under the Construction Act to be sufficiently well established that it need not be changed.
- 2.4 Finally we proposed that the equivalent of the section 110(2) notice in the Scheme should be retained as a means of ensuring that payments that become due under the Scheme are communicated. Respondents generally disagreed. It has become clear that, with or without the notice requirement, the Scheme suffers from the same problem as many contracts, in that it fails to make a sum due and clear to both parties by the due date.

3. There is a case for providing for an application for payment in the legislation in some form

- 3.1 The consultation document left this issue largely open to further discussion in responses, though it did state a preference for an application for payment in the legislation. Respondents generally supported the principle that the payee should have a right to apply for payment, though where the contract already provided an application process, this was felt to be satisfactory. Some respondents took the view that a third party certification process was equally satisfactory, especially as a means of determining the sum due under the contract after an application had been made. The responses suggested that a statutory application process running alongside the contractual process was unhelpful and unnecessary.

3.2 Some responses recommended a single statutory application process as a prescribed part of the contractual mechanism. This would require that the amount specified in the application would determine the amount due in the absence of a withholding notice under Section 111. Some responses went so far as to suggest such an application should also determine the due date so that an application could be issued at any time in order to make a payment due at that time for the work done. The consultation paper proposal would not have made the amount applied for become due or affected the due date. It left the sum due and the due and final dates to be determined by the contract. Some respondents saw little value in an application of this kind, while others supported it as an essential part of the payment mechanism. Others stated that such applications were commonplace anyway, even if the contract did not provide for them.

4. It is not necessary to redefine the content of withholding notices under Section 111

4.1 Respondents generally agreed that it was unnecessary to strengthen the requirement that withholding notices provide more detailed grounds for withholding.

4.2 Respondents were more divided over the question of whether withholding notices should state the amount remaining to be paid following the issue of the notice. Some respondents saw the proposal as a useful means of ensuring clarity as to the amount remaining to be paid. Others pointed out that the lack of clarity that exists under many contracts is a more fundamental problem. This is especially the case given the relative infrequency with which withholding notices are served. Though this is partly because payers are able to avoid issuing withholding notices for abatements and even equitable set-off, it also suggests that a large proportion of payments are managed without the need for set-off or abatement.

4.3 We have revisited a question briefly considered in the consultation paper relating to when withholding notices must be served. The question seems to illustrate the direct interconnection between sections 110(1) and 111 and the failure of many contracts at present to make a sum due. It seems clear that where a sum is due under the contract, as is required for Section 111 to apply, the legislation does not distinguish between different sorts of “withholding” (abatement and various sorts of set-off). It is only where no sum has become due under the contract that it is argued a payment can be abated without notice, as it was never due¹.

1. See *Rupert Morgan Building Services (LLC) Ltd -v- David Jervis and Harriet Jervis* [2003] EWCA Civ 1563, 12 November 2003.

5. There is a case for restricting the use of pay-when-certified clauses

- 5.1 Respondents were generally divided between those who wished to retain an unfettered right to use pay-when-certified clauses and those who wished to see the clauses made unenforceable. Many of the latter category wished to see all conditional payment clauses made unenforceable, though there was no clear assessment of the wider impact of this measure. A number of respondents suggested there was only limited justification in allowing for current management contracting and nominated subcontractor arrangements in the regulatory proposal.
- 5.2 The proposal in the consultation paper, to restrict the use of pay-when-certified clauses via regulation, received limited approval. Those who approved, raised specific questions as to how the regulation would work in practice and suggested possible technical problems with the proposed regulatory framework. Others expressed the view that the current framework, requiring an adequate payment mechanism, should be sufficient to allow adjudicators or the courts to deal with the unfair use of pay-when-certified clauses.
- 5.3 Few if any respondents engaged with the suggestion that pay-when-certified clauses and pay-what-certified clauses should be treated differently. In the consultation paper we had suggested that a subcontractor's work should be required to be certified individually under a pay-what-certified clause while it could still be certified as part of a wider package of works under a pay-when-certified clause. Many respondents who wished to see pay-when-certified clauses made unenforceable clearly objected to the practice of delaying payment because of defective work by other contractors.

Post-consultation proposals

Section 110(1)

We believe it is crucial that contracts provide certainty about what sums are due under the contract and when for the purpose of section 110(1). This was the intention of the original Act. We are therefore proposing amending section 110(1) to provide that a contractual mechanism is adequate only if it requires a statement of what is due in a certificate issued by:

- the payer; or,
- the payee (via an application or claim for payment); or,
- a third party named in the contract.

Where a certificate is not issued (resulting in non compliance with the contract), the payee would have the right to issue an application stating the sum due. The date of the application would then act as the due date, as it does under the Scheme for Construction Contracts.

The above proposal is intended to make pay-what-certified clauses unenforceable as the payment mechanism would be inadequate for the purposes of the revised section 110(1) requirement. Certificates issued by a third party under another contract would not be considered to state the sum due under the contract in question. As a result, the certificate could be ignored and the terms of the Scheme would apply.

This proposal is intended to create a clear understanding of what is meant by “the sum due” for the purposes of enforcing the requirement for withholding notices under section 111 and exercising the right of suspension under section 112.

Section 110(2)

We propose to remove the requirement for a section 110(2) notice. If a payer does not believe he should pay what is due under the contract he can utilise the mechanism in section 111. There is no need for two mechanisms.

The Scheme

For consistency, we also propose to amend the Scheme to ensure that, where the contract does not provide for certification of the sum due, it is determined by an application for payment from the payee. As currently under the Scheme, if the application is issued after the due date under the contract, the date of the application would act as the due date.

The removal of Part I paragraph 9 of the Scheme will be possible once this amendment is made.

Pay-when-certified

As explained above, the proposal to amend Section 110(1) would also prevent the use of pay-what-certified arrangements.

The practice of using pay-when-certified clauses continues to concern us. We are therefore considering prohibiting all clauses that make the receipt of payment under the contract conditional on the issue or content of a certificate from a third person under a separate contract. However the current extent of use of pay-when-certified clauses suggests that a significant regulatory intervention of this kind may require separate primary legislation. If it becomes clear this is the case, in the meantime there may be value in guidance on when the courts would be likely to view the use of pay-when-certified clauses as creating an inadequate payment mechanism under the Construction Act.

Chapter II – Other payment proposals

Improving the ability of the parties to a construction contract to manage cash flow and enable completion of work on the project in the event that problems arise for reasons outside of their control, such as defaulted payments, or disputes or insolvencies elsewhere in the supply chain.

The consultation proposals

We consulted on four proposals under this heading:

6. Introducing a right to reimbursement for the costs of suspension and remobilisation and to allow additional time for remobilisation under Section 112 of the Construction Act.
7. Making contractual provisions on cross contract set-off ineffective.
8. Making “pay-when-paid” clauses ineffective in cases of upstream insolvency proceedings.
9. Allowing stage payments under the Scheme to be made for materials in advance of their arrival on site.

The responses

6. **There is clear support for introducing a right to reimbursement for the costs of suspension and remobilisation under section 112 of the Construction Act and for allowing an extension of time for remobilisation.**
 - 6.1 Respondents were generally united in this view. However many pointed out that the current inability of suspending parties to claim the costs of suspension and remobilisation is not the only disincentive to suspending performance under the contract. Others are:
 - the consequences for future business between the suspending party and his employer; and,
 - the risk of wrongful suspension under the legislation at present as there may not be an established sum due under the contract to allow the payee to identify for sure whether it has been paid.

The proposal in the consultation paper would not address either of these issues. While the first potential consequence of suspension is unavoidable, the second should however be less of an issue under the proposal to amend section 110 of the legislation (described in Chapter 1 of this analysis).

6.2 The proposal in the consultation paper that the contract should set out the costs payable on suspension and remobilisation received a mixed reaction. The proposal that the Scheme should provide a basic fallback cost based upon the payment in default was generally rejected. However few respondents offered alternative proposals on how agreement might be reached between the parties. Some of the respondents that were against a contractual approach took the view that such an agreement would only ensure that the costs were the minimum possible and would not represent the genuine cost to the suspending party. Some respondents therefore stated that the costs should simply be determined under the common law of loss and expense and mitigation and that the contract need not play a part.

6.3 Respondents generally felt that an appropriate delay in remobilisation ought to be agreed on a case-by-case basis rather than set in the legislation.

7. There is a case for making contractual provisions on cross contract set-off ineffective, though there are a number of difficulties with this proposal

7.1 Generally respondents were supportive of the basic principle of limiting cross-contract set-off. The majority agreed with the proposal that the most effective way to do this was by making cross contract set-off clauses in contracts unenforceable. This proposal would not affect equitable set-off (erroneously called the “common law of equitable set-off” in the consultation paper) which allows set-off between two closely related contracts. The consultation paper raised the issue of set-off between contracts under framework agreements, stating our opinion that equitable set-off would be possible under such agreements. Though respondents generally agreed with this, some thought this approach would encourage litigation over which contracts under framework agreements would qualify for equitable set-off and considered a statutory definition of closely related contracts would be more appropriate. Some respondents were against the proposal in principle.

7.2 Some respondents identified an issue with the proposal for a contractor in insolvency proceedings who works for his employer on more than one contract containing cross-contract set-off clauses. In this instance cross-contract set-off clauses seem to have the effect of placing an employer in a position akin to that of a preferred creditor to the extent that he can set-off claims against payments to the contractor under the various contracts. This raises wider legal and economic policy considerations which concern us.

8. There is considerable support, though few new arguments for making “pay-when-paid” clauses ineffective in cases of upstream insolvency proceedings

- 8.1 Respondents were divided on this issue, some recognising that the current legislative provision was the result of a considerable compromise between the contracting and subcontracting sectors of the construction industry shortly before the original legislation was enacted. A large number of respondents argued in favour of prohibiting the use of pay-when-paid clauses in cases of insolvency of an employer further up the payment chain. Examples of arguments in favour of the legislative change are set out below:
- If pay-when-paid clauses apply in a contract and subcontract (or subcontract and subordinate subcontract), the contractor can generally pass on a larger proportion of his client insolvency risk using the clause than the subcontractor as he is more likely to make more payments to more payees and better able to secure his financial position by withholding them.
 - If the clauses do not apply in either contract, the contractor could well be better placed to manage the upstream insolvency risk than the subcontractor to whom it would otherwise be transferred. The contractor would be likely to have a higher and more frequent throughput of cash on a larger number of projects and would therefore be more likely to meet his debts without payment from an insolvent client.
- 8.2 These arguments need to be weighed against the question of whether any outcome in cases of insolvency is more preferable than any other, especially given the variety of firms in the construction industry. Some respondents pointed out that there are smaller and larger firms in all sectors and among clients. Any legislative solution needs to be preferable for all firms irrespective of their market power or their position in the supply chain. Though use of the clauses may be undesirable in various circumstances, the current framework at least leaves the parties free to agree what is best for them. Many respondents put the alternative argument that strong competition leads parties to sign contracts with clauses that may not be in their best interests.
- 8.3 Some respondents agreed with the suggestion in the consultation paper that insurance against upstream insolvency could be more straightforward if risk only arises from an immediate upstream insolvency. However this point was generally not picked up and insurance policies like this do not seem to be common.

9. There is limited support and some argument against allowing stage payments under the Scheme to be made for materials in advance of their arrival on site

- 9.1 Though respondents generally agreed that stage payments for materials held for work off site were necessary, views were mixed on whether legislation could be an effective tool to encourage these. One issue, raised, was the need to distinguish between materials for off-site fabrication and materials held in stock by a contractor offering a “supply and fit” service. A manufacturer who supplies and fits his products falls in between these two categories.
- 9.2 Respondents did not comment in detail on the proposed safeguard to ensure that ownership of materials is clear during the payment process. Some responses suggested this should remain a matter of contract, though they did want the Scheme to provide a right for payment. One response suggested ownership should remain with the payee, with payments effectively acting as down-payments. Other respondents identified that the proposal made no provision to protect the employer in the event of the insolvency of the supplier before materials are delivered to site. In this case no refund would be available.
- 9.3 Some responses expressed concern that we had not proposed any amendment to the primary legislation on this subject. The provision on stage payments in section 109 seems clear in providing that stage payments should be available for “any work under the contract”. Furthermore the Regulation 2(2)(a) of Part II of the Scheme provides for payments “equal to the value of any work... from the commencement of the contract”. Respondents did not generally comment on whether we had identified the problem correctly in observing that the provision in Regulation 2 (2)(b) of Part II requiring that payments for materials should only cover “materials manufactured on site or brought onto site”. Some respondents seemed to see the problem in different terms suggesting that securing stage payments under the present arrangement may not be possible at all before materials arrive on site. Two remedies were suggested:
- Providing in the Construction Act when the right to stage payments arises; and
 - Providing in the Construction Act that stage payments should be capable of application process making a payment become due at any time.

It is unclear to us why the first proposal is necessary given the current legislation or what basis there is to consider the problem serious enough to justify the second suggestion.

Post-consultation proposals

Section 112 right of suspension

The objective of improving the right of suspension is not simply to encourage its use to extract payment. The right is also intended as a means of allowing work on site and expenditure by suppliers to be reduced during periods when they are not paid.

In the light of responses we intend to provide a statutory right to the costs of suspension. However we do not consider that legislation or the contract itself can calculate what those costs should be. This is because the costs may well change during the course of the project and during the suspension period. It would be better for the payee to claim actual costs as they arise. We therefore propose the following framework:

- Suspension costs should be claimable as straightforward loss and expense after the event
- Should payment be made, remobilisation costs should be claimable for the remobilisation period as straightforward loss and expense after the event.
- The remobilisation period should be claimed as an extension of time when payment is made. The maximum period should be notified in the notice of suspension.
- In all three cases the common law duty to mitigate losses would apply and any dispute over the costs should be capable of adjudication.
- There may be some services that the suspending party proposes to continue to provide during the suspension period. These should also be stated in the notice of suspension to give the payer the opportunity to decide whether he agrees with such proposals. These might include services that would reduce the costs of remobilisation once the payment is made.

Cross-contract set-off clauses

We do not intend to take this proposal forward. We have concluded that a prohibition of cross-contract set-off clauses would need to include a statutory definition of closely related contracts as a general exception to the prohibition. As well as including framework agreements this would be needed to provide sufficient certainty over when the practice is possible via principles of equity. However well defined, we believe it is inevitable that litigation would arise over how the statutory definition applied and when it is possible to set-off between contracts. A further perverse impact could be that contracting parties seek to exploit this exception in more contracts than currently include cross-contract set-off clauses. A further point to note is that this is an area which insolvency law generally leaves to parties to agree in their contracts. Taking all these issues into account, our conclusion is that it is better for issues relating to set-off to be covered by the terms of the contract between the parties.

Pay-when-paid clauses in cases of insolvency

We do not intend to remove the existing exception to the prohibition of pay-when-paid clauses for cases of insolvency. This was the subject of a considerable pragmatic compromise on the part of government and industry when the Construction Act was passed in 1996. Though the consultation shed new light on the existing options these arguments applied equally in 1996. We do not consider that it would be appropriate to undermine that compromise without new evidence.

Stage payments for materials held for work offsite

We have concluded that this issue may be better suited to be addressed by guidance in the first instance. As it is, we have also concluded that a stand-alone amendment to secondary legislation, as we proposed in the consultation paper, cannot be made via a Regulatory Reform Order under the Regulatory Reform Act 2001. If this issue continues to be a problem following the publication of guidance, it would need to be addressed in the future via a separate statutory instrument. There remain a number of issues to be resolved if legislation were to be taken forward.

Chapter III – Adjudication Proposals

Reducing the disincentives to referring disputes to adjudication where it is suitable. The review has suggested these might include avoidance or frustration of the process or outcome, unnecessary legal challenge or unpredictable or excessive costs.

Consultation proposals

10. Preventing the use of “trustee stakeholder accounts” to suspend an adjudicator’s award pending litigation
11. Providing the adjudicator with the power to rule on certain aspects of his own jurisdiction and providing a right to payment in cases where the adjudicator stands down due to lack of jurisdiction
12. Providing the adjudicator with the right to open up “final and conclusive” decisions where these are of substance to interim payments only
13. Extending the adjudicator’s immunity to claims by third parties
14. Applying provisions on adjudicator independence from the Scheme to all adjudications

Responses

10. **There is support for preventing the use of “trustee stakeholder accounts” to suspend an adjudicator’s award pending final decision of the dispute at litigation**
 - 10.1 Respondents were generally in favour of this proposal in principle. They considered the ability of contracting parties to agree terms that negate the effect of adjudication to be a regulatory loophole in need of closure. Some contractors justify such clauses on the grounds that the recipient may become insolvent before the courts finally determine the dispute. The courts have now made clear the criteria by which they will grant a stay in enforcement of an adjudicator’s decision pending final determination². Respondents generally considered that only the courts should grant such a stay.

2. See Wimbledon Construction Company 2000 Limited -v- Derek Vago [2005] EWHC 1086, TCC 20 May 2005.

10.2 Respondents also generally rejected the proposal that these contractual clauses should be enforceable if the recipient of the adjudicator's award is insolvent. Even if such clauses are unenforceable, the courts would retain their ability to grant a stay in an adjudicator's decision and, if necessary, require payment of the adjudicator's award into the court. In any case, it seems there are serious practical and financial difficulties with an adjudicator acting as a trustee stakeholder pending final determination of a dispute, as we proposed to provide in the Scheme. It also seems that the concern that enforcement proceedings may be a costly way to obtain a stay in an adjudicator's decision was generally unfounded. Enforcement costs in court were not considered to be disproportionately high.

11. There is little justification for providing the adjudicator with the power to rule on certain aspects of his own jurisdiction. However there is a case for providing the adjudicator with a right to payment in cases where he stands down due to lack of jurisdiction.

11.1 As with part of the previous proposal, we are revisiting this one also, on the basis of feedback that the costs of court decisions on jurisdiction are not disproportionately high. The consultation considered whether the cost of adjudication and enforcement could be reduced if adjudicators could make binding decisions on jurisdictional questions. We proposed specific jurisdictional areas where a decision could be binding pending final determination.

11.2 The cost of leaving these decisions to the courts was a concern in Sir Michael Latham's review but the other reason for the proposal was the current problem that lots of jurisdictional challenges are made during an adjudication in order that they can be made again at enforcement proceedings. However, there is no clear indication that the number of jurisdictional challenges received by adjudicators would be reduced if they had the ability to make a binding decision on certain jurisdictional points. At least one respondent suggested guidance to adjudicators on jurisdictional challenges may need to be updated in the light of recent case law³.

11.3 Respondents generally supported the inclusion of a right to payment for adjudicators if they resign in response to a jurisdictional challenge. This would seem to remove a spurious motivation for adjudicators to complete a decision without jurisdiction as they may not be paid unless they do so.

3. One respondent raised AMEC Capital Projects Ltd -v- Whitefriars City Estates Ltd [2004] EWCA Civ 1418, 28 October 2004.

12. There is a case for providing the adjudicator with the right to open up “final and conclusive” decisions where these are of substance to interim payments only

- 12.1 Respondents were largely in favour of this proposal in principle but concerned by the potential imbalance between adjudication and other forms of dispute resolution if adjudicators alone had the right to open up final and conclusive decisions of this kind. Several respondents pointed out that, if the final and conclusive status of certain decisions was inappropriate, it should be made ineffective in general, not simply from the perspective of an adjudicator.
- 12.2 Otherwise than above, respondents generally agreed with the consultation paper that final and conclusive clauses created a loophole which put interim decisions outside the ambit of adjudication even though they are capable of revision by a subsequent decision under the contract. Some respondents pointed out that it would not be possible to rectify an interim decision via set-off from a payment determined by an adjudicator⁴. However this would not affect the payer’s general right to reclaim any sum that was not properly due. It has also been pointed out that interim decisions do not simply relate to payment but also to completion of work and extensions of time under the contract. It seems that where interim decisions are made on these matters, they should in general be capable of adjudication.
- 12.3 Some respondents pointed out that part of an interim decision may be of substance to the final account while another part might not be. For instance an interim valuation of works may include a decision as to the payment rate for a particular service or material, which would then be of substance to the valuation in the final account even though subsequent stage payments may revise the assessment of the extent of the service provided or the quantity of materials used. It would be necessary to take account of this in amending the legislation.

4. This was based upon the case of *Levolux A T Ltd -v- Ferson Contractors Ltd* [2003] EWCA Civ 11, 22 January 2003.

13. There is some support for extending the adjudicator’s immunity to claims by third parties but other respondents raised persuasive arguments to the contrary.

- 13.1 The proposal to provide adjudicators with statutory immunity raised a number of issues. Most significantly some respondents felt that in certain situations adjudicators should be liable for their actions as a matter of public policy. Decisions about the progress of works, or satisfactory completion of work have potential health and safety implications for which the adjudicator should be liable. Providing for immunity in these situations could deprive an innocent injured party of a reasonable right of action. Though these decisions are rare in adjudication (the majority of adjudications relate to disputes about payment), if legal action results, the adjudicator has access to professional indemnity insurance. If the adjudicator is concerned about incurring liability, he can also consult an expert witness who would then be liable for that part of the decision that is based on his advice.
- 13.2 The other point made was that adjudicators are not in any event likely to be held liable for claims such as economic loss, in which case immunity covering such cases is unnecessary.
- 13.3 Respondents considered the possibility of either claim being made to be very low, as they did the possibility of an adjudicator’s decision being influenced by the possibility of a claim.

14. There is support, though no clear case for applying provisions on adjudicator independence from the Scheme to all adjudications

- 14.1 Many respondents considered it would be sensible to move into the Construction Act the Scheme requirement for adjudicators to state any connection to the parties. This would represent a test of independence in addition to the existing requirement for impartiality in adjudications under the Construction Act. However there seemed to be little evidence from respondents to suggest this requirement was of value given the courts’ significant scrutiny of the existing impartiality requirement. Some respondents felt the emphasis of the consultation paper on an additional test of independence was misplaced given the emphasis in the Arbitration Act 1996 on impartiality only. Respondents suggested that a test of the independence could not guarantee impartiality and saw no clear reason why a wholly impartial adjudication could not be conducted by an adjudicator who failed the test of independence.

Post-consultation proposals

Preventing the use of “trustee stakeholder accounts” to suspend an adjudicator’s award – We propose to include a new provision in the Construction Act to prohibit the use of contract clauses which suspend the effect of an adjudicator’s decision until final determination.

Providing the adjudicator with the power to rule on certain aspects of his own jurisdiction – We do not intend to take this proposal forward. It may be that existing guidance to adjudicators on jurisdictional challenge needs to be updated in the light of recent case law.

Providing the adjudicator with a right to payment in cases where he stands down due to lack of jurisdiction -We intend to insert a provision in the Construction Act entitling the adjudicator to payment if he stands down in response to a jurisdictional challenge.

Providing the adjudicator with the right to open up “final and conclusive” decisions where these are of substance to interim payments only – We intend to include a provision in the Construction Act making “final and conclusive” clauses unenforceable if they apply to decisions that are interim in terms of their capacity to be revised by a subsequent decision under the contract.

Extending the adjudicator’s immunity to claims by third parties and applying provisions on adjudicator independence from the Scheme to all adjudications – We do not intend to take these proposals forward.

Adjudication costs – We are also taking forward the Government’s existing commitment on adjudication costs. This was set out in the introduction to the consultation paper and was generally supported. We therefore intend to:

- set a basic position in the legislation that the parties to an adjudication should bear their own legal and other costs; while,
- the costs of the process (the adjudicator’s fees and expenses and the costs of his appointment) are referred to the adjudicator to be decided as part of his decision of the dispute.
- Provide that any agreement⁵ in the contract with an effect other than above will be ineffective; and that,
- Once a dispute has been referred to an adjudicator, if both parties also wish to refer the legal costs they incur in the process, the adjudicator should also allocate these as part of his decision of the dispute.

5. Such as the agreement in the case of *Bridgeway Construction Ltd -v- Tolent Construction Ltd* , unreported, 11 April 2000, TCC, Liverpool.

Annex 1 – List of consultation respondents

Breakdown of numbers of responses by type of respondent

- Construction Firms (282):
 - ...of which 270 were standard responses from members of the:
 - Construction Confederation (98)
 - Specialist Engineering Contractors' Group (128)
 - National Specialist Contractors Council (44)
- Trade and client bodies (10)
- Professional bodies / Adjudicator Nominating Bodies (15)
- Construction professionals / Consultancies (17)
- Legal Bodies / Legal Firms / Solicitors / Barristers (17)
- Other (6)

...plus responses from 8 bodies involved in Sir Michael Latham's review of the legislation

- Construction Confederation (Response number 0178)
- Construction Clients Group (Response number 0337)
- Construction Industry Council (Response number 0349)
- Construction Umbrella Bodies Adjudication Task Group (Response number 0343)
- Federation of Master Builders (Response number 0286)
- National Specialist Contractors Council (Response number 0293 – the response covered payment issues only but stated support for response number 0244 on adjudication)
- Specialist Engineering Contractors Group (Response number 0329)
- Technology and Construction Solicitors Association (Response number 0346)

Country of origin:

- England – 312
- Wales – 13
- Scotland – 26
- Northern Ireland – 6

The consultation responses can all be accessed via the internet at:
www.dti.gov.uk/construction/hgcra/consult_resp.htm

A list of respondents is also available on the website.

Annex 2 – Proposals that were not subject to formal consultation as part of this exercise

Sir Michael Latham’s review raised issues and made proposals in several areas that we did not formally consider as part of the consultation exercise. However in an annex to the consultation paper, we explained that we were interested in comments respondents might have on the importance and appropriateness of the proposals.

The proposals fell into three main categories:

- Issues previously consulted on in “Improving adjudication in the construction industry”
- Proposals to legislate only to provide clarification of the existing law as established by the courts
- Proposals to legislate to introduce measures for construction contracts affecting the framework of other late payment or insolvency legislation relating to all industry sectors

Others were:

- Amending the meaning of “evidenced in writing”.
- Amending the scope.

In the consultation paper, we gave a longer explanation of our reasons in several cases. Comments from respondents on the decision not to take forward consultation on these recommendations have been mixed but relatively infrequent. We have not undertaken the same kind of formal analysis of responses as we have for the consultation paper material but we have considered the points raised. The purpose of this annex is to respond to those points where they were new and where it is helpful to add to the discussion at the end of the consultation paper.

Introducing a single adjudication procedure for all adjudications – After we stated this proposal had been subject to consultation in 2001, it was pointed out to us that the DETR Consultation paper on “Improving Adjudication in the Construction Industry” (2001) did not specifically consult on this issue. Instead it discussed the proposal, stating that “...it would be premature to consider amending the Construction Act...”. However, a number of respondents took the opportunity in 2001 to comment on the proposal and raised objections in principle, including several construction industry representative bodies. Given that Sir Michael Latham’s review group was still

not fully in favour, and that respondents did not take the opportunity to present new evidence in their responses to the consultation in 2005, we have no intention to take this proposal further forward. The industry may wish to consider whether to bring its own standard adjudication procedures more closely into line with one another.

Amending the meaning of “evidenced in writing” – A number of respondents have taken issue with the position taken in the consultation paper that we agreed with the decision of the Court of Appeal in *RJT Consulting v DM Engineering*⁶ on the meaning of “contracts evidenced in writing” for the purposes of section 107 of the Construction Act. Their concerns are as follows:

- When construction contracts are agreed, this is usually based upon an incomplete agreement of the contract terms, with an understanding that a full agreement will be finalised in time. This is a consequence of a process where work is advertised and tenders submitted on the understanding that a particular standard form of contract will be used. A tender is then accepted and only at that stage will one or both parties submit to each other a schedule of bespoke amendments which they routinely make to the standard contract in question. The amendments must then be considered, accepted or rejected and reconciled against one another. This process is often left incomplete leaving grounds for a dispute about whether the contract was finalised and fully recorded in writing and whether the Construction Act applies.
- Section 107 is based on the drafting of section 5 of the Arbitration Act 1996, which requires that an arbitration agreement between the parties to an arbitration should be evidenced in writing. In that context the provision makes sense as there is no statutory fallback where an arbitration agreement is not properly recorded. Respondents have suggested the provision does not make sense as it has been interpreted in the case of adjudication where the requirement that all the contractual terms should be agreed in writing seems to be excessively narrow. In the case of adjudication, there is a statutory fallback procedure, so the adjudication procedure does not need to be agreed in writing, or with certainty, for the legislative framework to be effective. By a similar argument none of those parts of the contract where the Scheme provides a fallback need be agreed in writing.

⁶ *RJT Consulting Engineers Ltd -v- DM Engineering (NI) Ltd* [2002] EWCA Civ 270, 8 March 2002

- The decision of an adjudicator about the terms that were agreed in the contract can be equally complex whether or not the contract was recorded in writing. The parties may disagree over which was the final agreement or which proposed contract form or contractual amendments applied and which did not. Similarly, the decision of an adjudicator about agreements made during the progress of works can be equally complex, again irrespective of whether those agreements are recorded in writing. In each case the adjudicator must decide what agreement was made, based upon the evidence and the balance of probabilities. The effect of the courts' narrow interpretation of section 107 is to allow adjudicators to make decisions on any agreement, other than a contractual agreement where it is not recorded in writing.

We wish to consider further the extent to which the current situation can be improved by an amendment to the legislation. However it is clear that an amendment to Section 107 of the Construction Act is not possible by a Regulatory Reform Order under the Regulatory Reform Act 2001, as is proposed for the other amendments which we are taking forward following the consultation. We therefore wish to consider whether it will be necessary to legislate separately on a longer timescale. This is likely to be a matter for consultation in the future.

Annex 3 – Cabinet Office Consultation Code Of Practice

The six consultation criteria

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

The complete code is available on the Cabinet Office website at:

www.cabinetoffice.gov.uk/regulation/consultation/code.asp

Annex 4 – Statistical breakdown of responses to questions in the consultation response form

The consultation paper ended each section by asking a series of questions about the proposals in that section, and their potential regulatory impact. A selection of these questions were brought together at the end of the consultation paper in a consultation response form. The following is a summary of a statistical analysis of answers received to the questions in the response form. We did not feel it was appropriate to undertake a statistical analysis of responses to the other questions given the small sample of responses. We have also not included in the analysis the answers to questions that requested a text answer rather than a selection from a series of options or a quantitative response.

The analysis does not weight responses. Some forms were completed by representatives of large numbers of firms while others were completed by a single individual. We have not distinguished between them. We have removed any responses which were clearly photocopies or duplicates of other responses we had received. We considered that these were comparable to the large number of letters we received from respondents supporting other organisations' responses.

Based up on the above criteria, in total we analysed 55 responses.

Chapter 1

Q1.1 Do you agree that the payment framework under the Construction Act would benefit from the inclusion of a definition of what should constitute an adequate mechanism for payment?

Yes – 40 (78% of answers)

No – 11 (22% of answers)

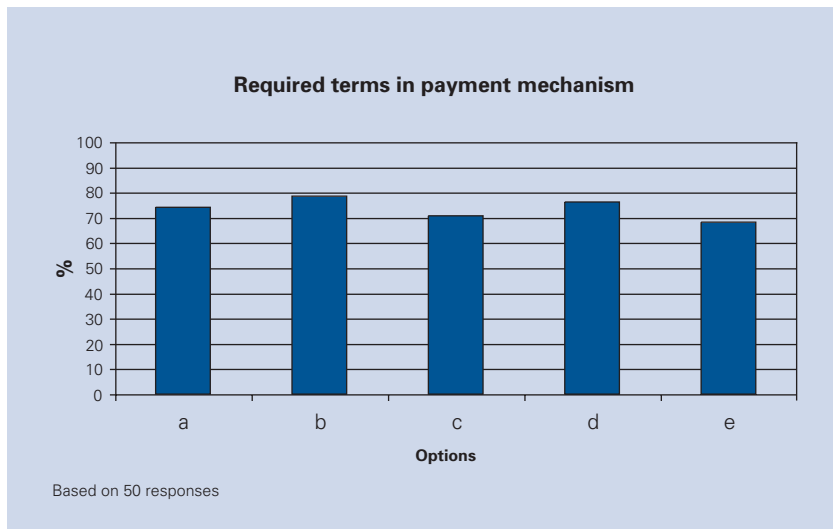
NA (no answer) – 4

While some respondents suggested this approach was unnecessarily prescriptive, others felt the current section 110(1) requirement was in need of clarification. Others suggested such clarification could be provided in guidance.

Q1.3 Do you agree that the adequate mechanism should be expressly required to include terms stating:

- a) What amounts constitute the payment under the contract;
- b) When a payment is to be assessed under the contract;
- c) How are the amounts to be determined;
- d) The period of time that should elapse from the point of assessment of the payment is to be ascertained before the final date for payment;
- e) What information is to be communicated between the parties (who provides what, to whom and in what level of detail during the process);

Percentages of respondents answering **Yes** to each part of this question are illustrated below.



Some respondents expressed the concern that we might be proposing that section 110(1) should prescribe the terms contracts should contain in each of the areas listed above. In fact, we were proposing that section 110(1) should require the contract to contain terms in each of these areas. The terms themselves would be agreed by the parties.

Q1.6 Assuming that the requirement for an adequate mechanism in the Construction Act were included as proposed, do you agree that the mechanism in the Scheme satisfies all of the requirements of the payment mechanism as proposed?

Yes – 28 (64% of answers)

No – 16 (36% of answers)

NA – 11

Some respondents raised the problem that the Scheme does not state whose valuation should be understood to be the sum due under the contract.

Q2.2 Do you agree that the requirement in section 110(2) should be removed and that in its place the legislation should clearly define what is meant by “an adequate mechanism for determining what payments become due under the contract, and when”?

Yes – 32 (65% of answers)

No – 17 (35% of answers)

NA – 6

Responses were coloured by the fact that some respondents were against the proposal to define what is meant by an “adequate mechanism” in Section 110(1). A number of respondents were in favour of retaining section 110(2) in the absence of clear provision in the Construction Act on the communication of the sum due.

Q2.3 If we remove this requirement, do you agree that at the same time the concept of a “due date” should be removed from the legislation in favour of, for instance, an “assessment date”?

Yes – 30 (65% of answers)

No – 16 (35% of answers)

NA – 9

Some respondents expressed doubts about changing a provision in the Construction Act which was generally understood.

Q2.5 If the requirement for a payment notice in section 110(2) were to be removed, do you agree that the requirement for a payment notice in Part II Section 9 of the Scheme should be retained as a fallback payment mechanism for cases where the mechanism in the contract proves inadequate?

Yes – 34 (74% of answers)

No – 12 (26% of answers)

NA – 9

Some respondents raised the problem that in the absence of Part II Section 9, the Scheme would make no provision as to the communication between the parties of the sum due.

Q2(i) If you believe that the requirement for Section 110(2) notices should be dropped would this offset any burden resulting from the proposed change to Section 110(1)?

Yes – 11 (31% of answers)

No – 24 (69% of answers)

NA – 20

A number of respondents commented that:

- *communication of the payment was a business requirement anyway;*
- *there is no sanction under the legislation for non-compliance with the payment notice requirement;*

...on this basis they considered the removal of section 110(2) represented less of a reduction in regulatory burden than we had supposed. Since the publication of the consultation document, the Cabinet Office has developed a framework for measuring the administrative burden imposed by regulation. It would discount both these factors on the basis that a regulatory requirement has to be followed and, as such, imposes a cost.

Q2(ii) What would you estimate to be the financial cost of serving a section 110(2) notice (£ per payment).

10 respondents made specific estimates.

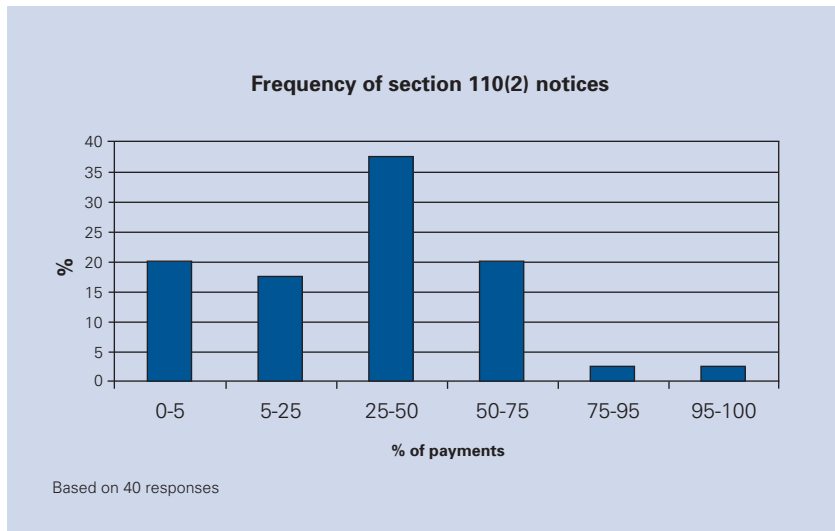
Mean – £33.15

Median – £15.00

We have taken the view that the cost of issuing a payment notice is approximately £25.00 per payment.

Q2(iii) How frequently do you believe Section 110(2) notices are served under construction contracts?

Answers are illustrated in the graph below.



Mean – 34.25

Median – 37.5

Mode – 37.5

We consider that it is reasonable to conclude there is approximately a 40% level of compliance with the contractual requirement for a payment notice in line with Section 110(2).

Q2(iv) How often do you believe a payment dispute arises in part due to a payer's failure to serve payment notice under Section 110(2) of the Construction Act and / or the misunderstanding that there is a legal entitlement to payment of the amount in the notice if it is served?

- a)** as a result more than one in 10 failures to serve a payment notice – **13**
- b)** as a result of between one in 10 and one in 100 failures – **11**
- c)** as a result of fewer than one in 100 failures to serve a payment notice – **13**
- no answer – **18**

Based upon this response we favour option (b).

Q3.1 Do you believe that an application should be available for a payee to submit...

- a)** as of right when necessary (as in our suggested proposal) – **28**
- b)** as a requirement of a contract that complies with the Construction Act – **11**
- c)** where the contract does not contain any provision for an application – **1**
- d)** other (please specify)? – **0**
- e)** not at all? – **7**
- no answer – **8**

It seems some respondents preferred option a) over option b) on the basis it was less prescriptive as to contract terms. Others may have seen it as more effective to be able to intervene in the operation of agreed terms under a statutory right, rather than have any agreement of those terms controlled by statute.

Q3.5 Do you believe the payer should have:

- a)** no right of response to the application? – 5
- b)** a general right of response to the application? – 21
- c)** a specified right of response with requirements as to content and / or timing of the response (please specify)? – 18
- d)** other – please specify? – 1
no answer – 10

The one respondent who specified option (d) appeared to be recommending a variant of option (c).

Q3.7 Do you believe that the amount applied for should become payable by the specified final date for payment under the legislation?

- a)** No (as in our proposal)? – 17
- b)** Yes – but only if the payer has not responded to the application? – 15
- c)** Yes – though only to the extent considered appropriate by an adjudicator, arbitrator or court in certain circumstances? – 1
- d)** Yes – but only to the extent agreed by the payer (leaving adjudication etc to settle any disputes)? – 5
- e)** Yes – under the legislation as an automatic requirement in certain circumstances? If so, which circumstances? – 3
- f)** Yes – other (please specify)? – 1
No answer – 13

Those answering options (e) and (f) suggested parts of a payment mechanism that might apply specifically to pricing contract variations. Others might have been trying to identify an approach somewhere between those of options (a) and (b).

Q3(i) What do you believe is likely to be the administrative cost of a) issuing an application under the legislation as described in section 3.5 and b) receiving such an application? How would this compare to current costs? (please specify your answer in £ per payment applied for)

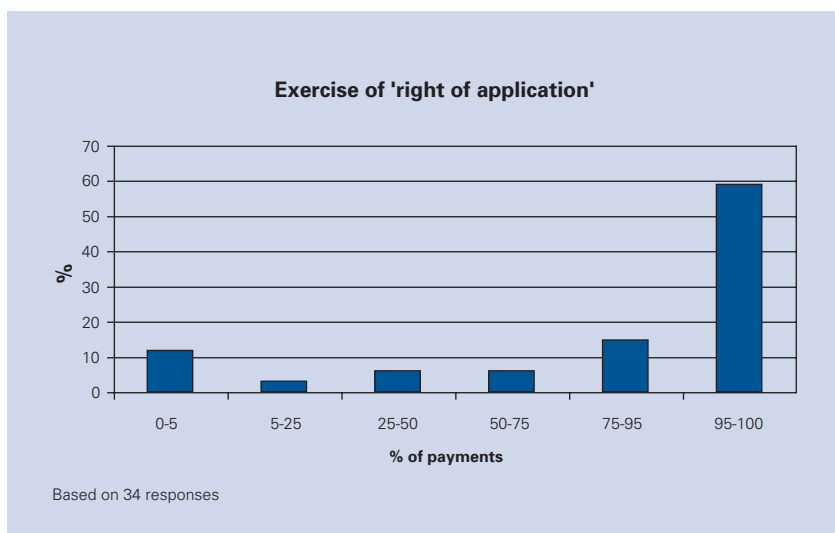
Only two respondents felt able to estimate specific amounts, though some others suggested a range of costs. It was clear that many felt the increased cost for the applicant was very low given that applications are issued routinely in any case, often even where the contract does not provide for an application process. It was not clear what respondents felt the cost implications may be for the recipient.

- Q3(iii)** Which of the following do you think would be the most likely way in which the right of application proposed in section 3 would be used?
- a)** In response to the large majority of payment transactions under the existing legislation or the proposed “adequate mechanism” – **28**
 - b)** When the payee is unhappy with the amount proposed to be paid – **1**
 - c)** When the payee believes the contractual payment mechanism has failed and an amount should have been ascertained – **4**
 - d)** At the conclusion of the withholding period under Section 111 of the Construction Act when the payee is unhappy with the amount proposed to be withheld and / or paid – **1**
 - e)** When the payee believes he has not received the payment due by the final date for payment under the contract? – **1**
 - f)** Other – please specify – **0**
- No answer – **20**

Though a large number of respondents felt unable to answer this question, the response does appear to illustrate the extent to which a right of application in the legislation would be likely to run alongside almost every majority of contractual mechanism.

- Q3(iv)** Given your answer above, how frequently do you believe the right of application would be exercised under the proposal in section 3.5?

Answers are illustrated in the graph below.



Mean – 76.5%

Median – 97.5%

Mode – 97.5%

Given the number of respondents who did not answer, it is difficult to draw any clear conclusions, but we consider that the use of the application process that we proposed in the consultation paper would become predominant in the industry.

Q3(v) Do you believe the number and complexity of disputes in the construction industry would be likely to increase or decrease by issuing an application under the proposal in section 3.5? Please indicate your reasons.

Increase – 4

Decrease – 15

No change – 19

No answer – 17

As with other questions in this section, responses revealed some respondents may not have understood the preferred application framework in the consultation paper.

Q4.2 Do you agree that following the removal of Section 110(2) and the inclusion of a definition of an “adequate mechanism” in Section 110(1), Section 111 should include a requirement to state the amount the paying party intends to pay as well as the amount(s) to be withheld?

Yes – 38 (79% of answers)

No – 10 (21% of answers)

NA – 7

Among those disagreeing with the proposal some considered it would make little difference to the present situation.

Q4.3 Do you agree that it would not be appropriate to amend the legislation to include a description of what would represent “sufficient detail” when giving grounds for withholding payment in a Section 111 notice?

Yes – 25 (54% of answers)

No – 21 (46% of answers)

NA – 9

The consultation paper’s position on this issue met with a mixed response. It was clear that many respondents wanted to ensure the withholding process was as effective as possible at identifying the reasons for withholding payment. Others pointed out that the reason for the notice was only to allow the payee to consider whether the amount withheld represented grounds for a dispute. The full reasons for withholding would then be provided during the dispute resolution process.

Q4(i) Do you agree with our assessment that there is only a negligible cost to the payer of stating the payment he now intends to pay when issuing a withholding notice?

Yes – 38 (90% of answers)

No – 4 (10% of answers)

NA – 13

Some respondents pointed out that this assessment in itself does not justify the legislative change.

Q5.4 Do you agree that where a pay-when-certified arrangement is provided in a contract...

a) ...the contract should identify the element of the works in the certificate, of which the subcontract work forms a part and when the certificate will become due under the main contract for the element in question?

Yes – 30 (77% of answers)

No – 9 (23% of answers)

NA – 16

b) ...the contract should require that a copy of the certificate is passed to the subcontractor within five days of the assessment date?

Yes – 29 (72% of answers)

No – 11 (28% of answers)

NA – 15

Q5.5 Furthermore, do you agree that where the amount to be paid under the subcontract is to be determined by the certificate under the main contract (a pay-what-certified arrangement), the subcontract should...

a) ...provide that the work will be priced individually in the certificate as part of the package of work it covers?

Yes – 29 (72% of answers)

No – 11 (28% of answers)

NA – 15

b) ...describe how the payment due under the subcontract will be ascertained based upon the price in the certificate?

Yes – 29 (76% of answers)

No – 9 (24% of answers)

NA – 17

Q5.6 Do you believe that the proposal is appropriate for management contracting arrangements where they involve pay-when-certified clauses?

Yes – 26 (60% of answers)

No – 17 (40% of answers)

NA – 12

Q5.7 Do you believe that the proposal is appropriate for contracts with nominated subcontractors where they involve pay-when-certified clauses?

Yes – 31 (72% of answers)

No – 12 (28% of answers)

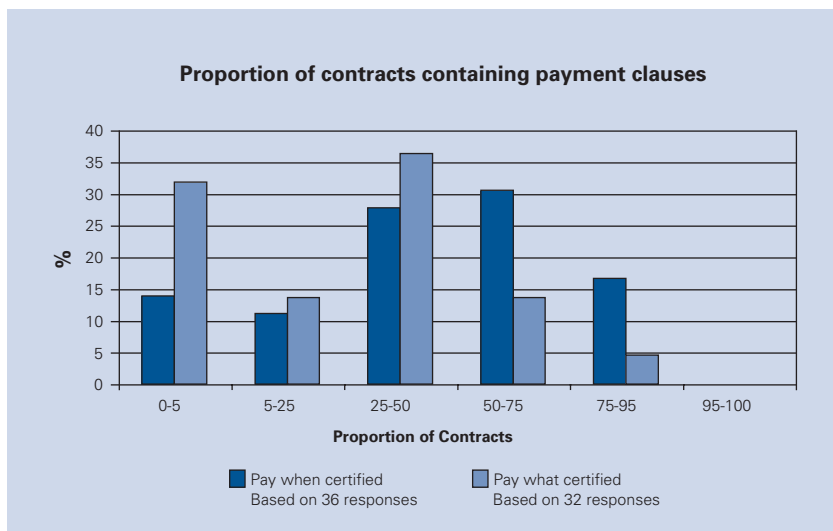
NA – 12

The consultation response form only sought views on the framework for regulating the use of pay-when / what-certified clauses. It is not clear how many would have rejected regulation in favour of making all these clauses unenforceable if the question had been asked. However many who rejected the proposed regulation or declined to respond to the questions expressed concerns in principle about the use of these clauses.

Q5(i) What proportion of subcontracts do you believe contain pay-when-certified clauses for one or more payment stages?

Q5(ii) What proportion of contracts do you believe contain pay-what-certified clauses for one or more payment stages?

Answers to these questions are illustrated on the graph below.



Q5(i) Mean – 46%
Median – 37.5%
Mode – 62.5%

Q5(ii) Mean – 29%
Median – 37.5%
Mode – 37.5%

We consider that pay-when-paid clauses may be used in approximately 50% of contracts. Given the low response on pay-what-certified clauses, an estimate is somewhat unreliable but they may be used in approximately 25% of contracts.

- Q5(iii)** How often do you believe a payment dispute arises in part due to the inclusion of a pay-when certified or pay-what-certified clause?
- a)** as a result more than one in 10 clauses in contracts – **8**
 - b)** as a result of between one in 10 and one in 100 clauses in contracts – **17**
 - c)** as a result of fewer than one in 100 clauses in contacts – **6**
- no answer – **24**

Chapter 2

Q6.1 and Q6.2 Do you agree that it is necessary to supplement the right to suspend performance under the contract? Do you believe that an enhanced right of suspension should include:

- a)** the right to recover the reasonable costs of suspension?
- b)** the right to recover the reasonable costs of remobilisation?
- c)** the right to require an appropriate delay in remobilisation?

Yes – 45 (92% of answers)

No – 4 (8% of answers)

NA – 6

This was the strongest expression of support for any of the proposals in the consultation paper.

Q6.3 Do you agree that the issue of what constitutes:

- a)** the reasonable costs of suspension;
- b)** the reasonable costs of remobilisation; and,
- c)** an adequate delay in remobilisation...

...is best dealt with as a matter of contract?

Yes – 38 (81% of answers)

No – 9 (19% of answers)

NA – 8

Respondents answering “no” expressed concerns that certain contractual agreements could minimise the costs that were payable.

Q6.5 Do you agree that the fallback provisions should...

a) ...set the reasonable maximum cost of suspension and remobilisation 5% of the value of the payment in default?

Yes – 9 (20% of answers)

No – 36 (80% of answers)

NA – 10

b) ...set the appropriate maximum delay in remobilisation at seven days?

Yes – 11 (24% of answers)

No – 35 (76% of answers)

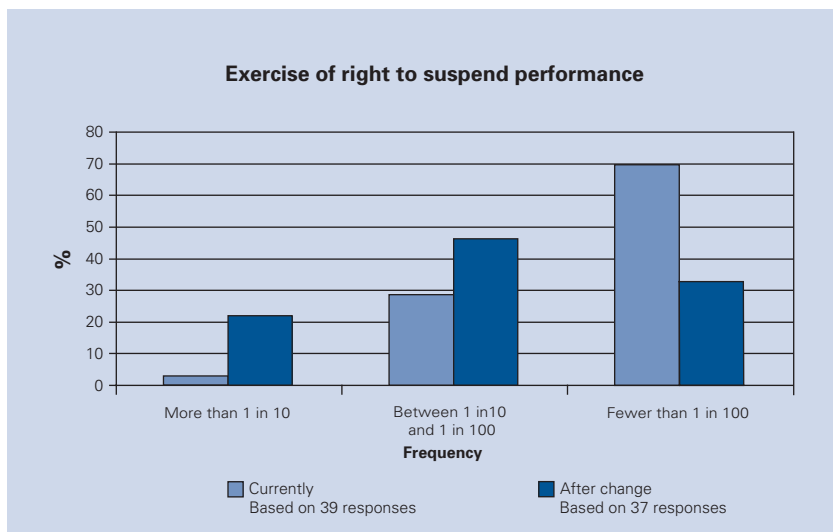
NA – 9

Respondents voting “no” generally expressed doubts about a “one size fits all” approach.

Q6(i) How frequently in cases of defaulted payment do you believe the right to suspend performance under the contract is exercised?

Q6(ii) Under the proposed change in the law, how frequently do you believe the right to suspend performance under the contract will be exercised?

Answers to these questions are illustrated on the graph below.



It is possible to interrogate the responses to this question to work out how many respondents thought there would be a marked increase or decrease in the use of the right of suspension under the Construction Act. The figures show: increase – 18; decrease – 1; no significant change – 18; no answer – 18.

Q6(iii) What do you believe are the typical costs of suspension of performance? (£)

Q6(iv) What do you believe are the typical costs of suspension of performance? (£)

Only six respondents were able to estimate specific amounts in answer to these questions, though some others suggested a range of costs. Some respondents considered that the suspension costs would increase during the period of suspension and offered an estimate of £ per week / month.

Q7.1 Do you believe that the use of cross contracts set-off clauses should be limited?

Yes – 32 (67% of answers)

No – 16 (33% of answers)

NA – 7

Q7.2 Do you believe that the definition of “equitable set-off” (“a close relationship exists between the dealings and transactions which gave rise to the respective claims”) provides sufficient flexibility to meet the reasonable requirements of the construction industry?

Yes – 30 (68% of answers)

No – 14 (32% of answers)

NA – 11

Responses to these two questions varied significantly. While some respondents wanted to limit the ability of parties to agree cross contract set-off clauses, they believed the definition of equitable set-off was not sufficient for the needs of the construction industry. Meanwhile other respondents did not want to limit use of these clauses but were concerned by the possibility of an exception in the legislation allowing the clauses to be used in certain circumstances.

Q7.3 Do you believe that cross-contract set-off should generally be permitted where the work is part of a series of projects under framework or similar agreements? If yes please explain which contracts / commercial arrangements would fall into this category which you believe would not be covered by the right of equitable set-off.

Yes – 29 (62% of answers)

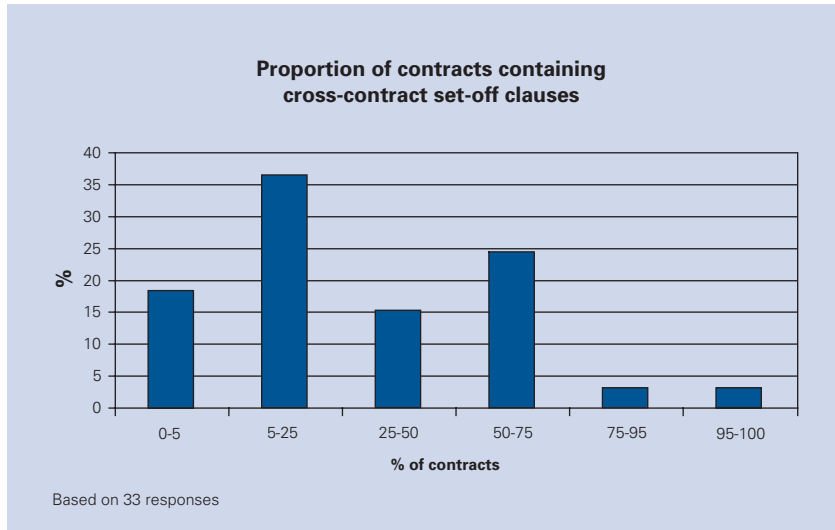
No – 18 (38% of answers)

NA – 8

Some respondents answering “no” expressed concerns about the cost of disputes about whether particular framework agreements would allow equitable set-off between the contracts underneath them or would not.

Q7(ii) How often do you believe contracts contain cross-contract set-off clauses?

Responses to this question are illustrated on the graph below.



Mean – 32%

Median – 15%

Mode – 15%

It seems reasonable to consider that perhaps 20% of contracts contain cross contract set-off clauses.

Q7(iv) Do you believe that invoking cross contract set-off clause in a contract is likely to...

- a) ...cause or escalate a dispute between contracting parties? – 21**
- b) ...shift a dispute from one project to another project to another project without resolving it? – 23**
- c) ...help to prevent or resolve a dispute between contracting parties? – 3**
- no answer – 24**

This question was not stated clearly. While some respondents answered this question by opting for (a) or (b) or (c), others chose more than one option. The figures above treat all responses as if respondents could have chosen more than one option.

Q8.1 Do you believe it is beneficial for the industry to retain the ability to invoke “pay-when-paid” clauses in cases of “upstream” insolvency proceedings?

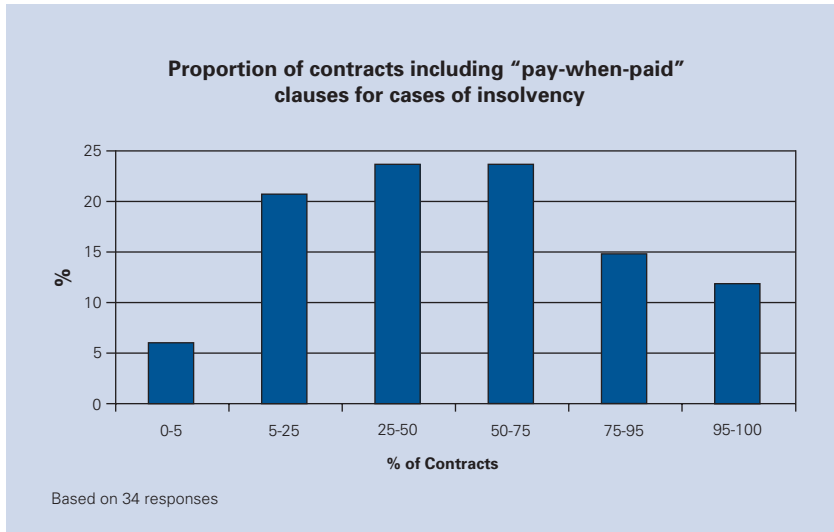
Yes – 15 (33% of answers)

No – 30 (67% of answers)

NA – 10

Q8(iii) How frequently do you believe pay-when-paid clauses are included in contracts?

The answers to this question are illustrated on the graph below.



Mean – 51%

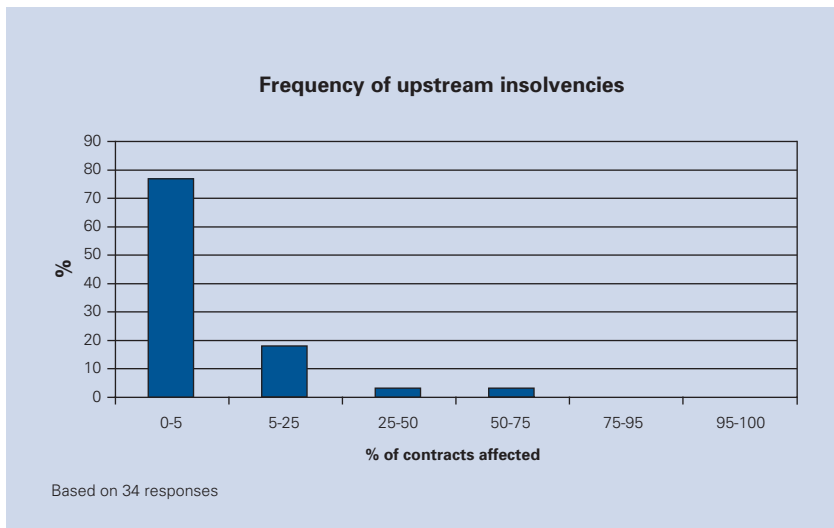
Median – 50%

Mode – 50%

We have concluded that it is reasonable to assume pay-when-paid clauses appear in approximately 50% of contracts.

Q8(iv) How frequently do you believe upstream insolvencies arise under construction contracts?

The answers to this question are illustrated on the graph below.



Mean – 8%

Median – 2.5%

Mode – 2.5%

We have concluded it would be reasonable to assume pay-when-paid clauses appear in 5% of contracts.

Q8(v) How frequently do you believe pay-when-paid clauses are invoked where they are included in construction contracts and an upstream insolvency occurs?

a) More than half the time? – **30**

b) About half the time? – **0**

c) Less than half the time? – **3**

No answer – **22**

It seems reasonable to conclude that pay when paid clauses are invoked on perhaps two thirds of the occasions when it is possible to do so.

Q9.1 Do you agree in principle that the Scheme should make provision for stage payment for materials held off-site and off-site work upon them if this is possible?

Yes – 30 (58% of answers)

No – 22 (42% of answers)

NA – 3

Q9.2 If so, what conditions do you believe should apply for payment to be required for work off-site under the Scheme?

a) That ownership of the materials paid for is substantiated as having transferred to the payee?

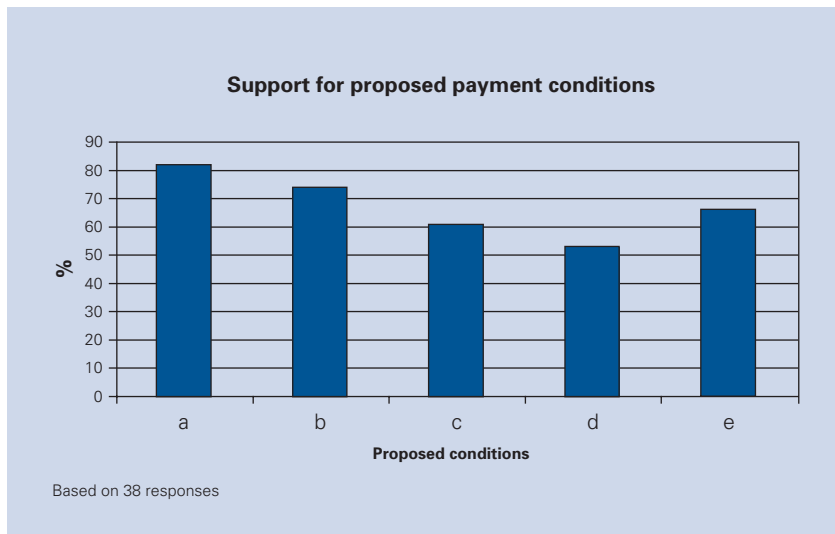
b) That access will be provided to the payer, on demand, for inspection or collection?

c) That a full refund for the value of the materials owned by the payer off-site will be available, with the return of ownership to the payee?

d) That a refund should also be available for any work done on the materials and components under paragraph 2(2)(a) of the Scheme, once their ownership has transferred to the payer?

e) That this refund should become available in cases where the work did not meet the original specification?

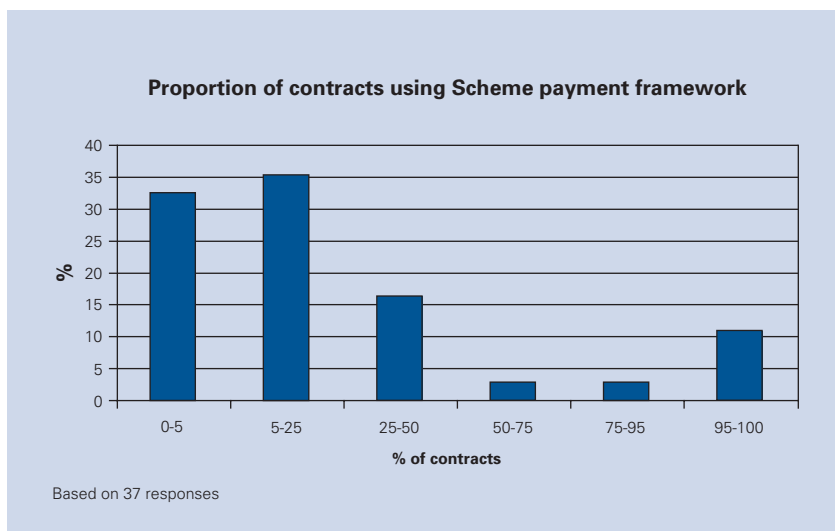
Percentages of respondents answering **Yes** to each part of this question are illustrated below.



This question did not make clear whether or not respondents should answer on the basis that an amendment was going to be made. However most respondents appear to have answered it in this way, with those against any amendment to the Scheme either commenting on each specific feature of the regulation or declining to answer at-all.

Q9(i) How often on projects do you believe the payment framework in the Scheme is used (either by agreement as a fallback mechanism or fallback framework for stage payments)?

Answers to this question are illustrated on the graph below.



Mean – 26%

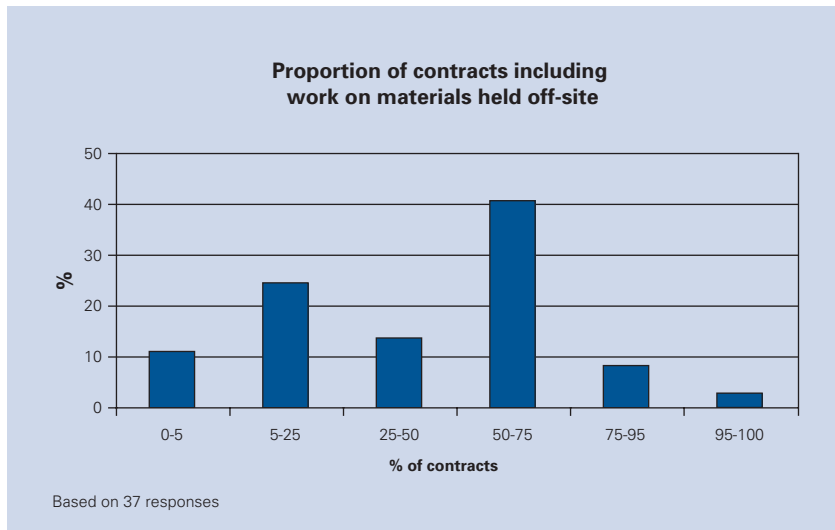
Median – 15%

Mode – 15%

It seems that the payment provisions of the Scheme are frequently invoked in some way (in approximately 25% of projects). It was not clear from the question whether this was simply to provide contractual payment periods or to provide a means of evaluating stage payments.

Q9(ii) How often do you think projects include work on materials held off-site for delivery to site at a later stage (irrespective of whether stage payments are provided)?

The answers to this question are illustrated on the graph below.



Mean – 49%

Median – 62.5%

Mode – 62.5%

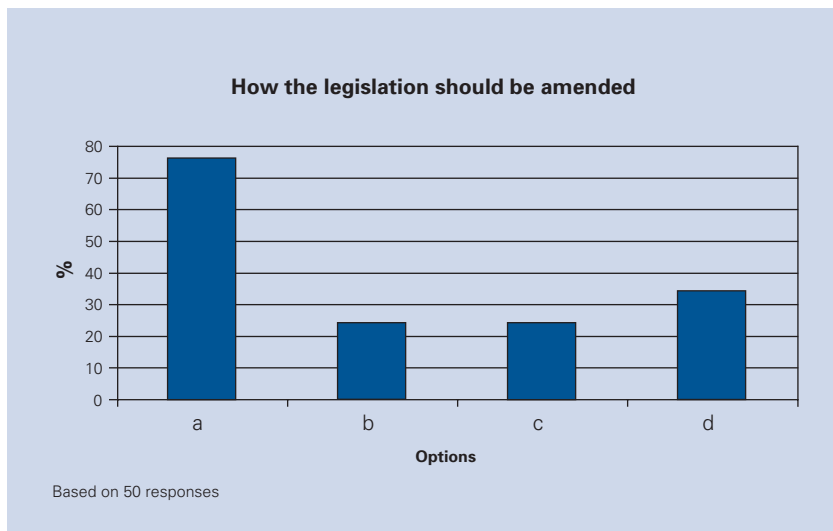
It seems reasonable to consider that about 50% of projects include work on materials held off-site.

Chapter 3

Q10.2 If you think the current practice is not appropriate, how do you think the legislation should be amended to improve cash flow and the effectiveness of the adjudication process? Should we include:

- a)** a provision in the Construction Act to make unenforceable contractual provisions requiring the payment of an award into a trustee stakeholder account?
- b)** a power for the adjudicator to overrule any contractual provision requiring the payment of his award into a trustee stakeholder account?
- c)** a broader power for the adjudicator to overrule any contractual requirement for payment at all to be made into a trustee stakeholder account (not simply the adjudication award)?
- d)** a broader power for the adjudicator to overrule any contractual requirement at all which has the effect of delaying the effect of his decision?
- e)** Other – please specify.

Percentages of respondents answering **Yes** to each part of this question are illustrated below.



It is clear that a provision making these provisions unenforceable received most support. In fact a number of respondents who approved option (d) (the second most popular) did so in addition to option (a).

Q10.3 Do you believe that the adjudicator should be allowed to make his award into a trustee stakeholder account in cases where the receiving party is subject to insolvency proceedings.

Yes – 14 (30% of answers)

No – 33 (70% of answers)

NA – 8

If so, should this be possible:

a) under all adjudications, by including a requirement in the Construction Act?

Yes – 6 (13% of answers)

No – 39 (87% of answers)

NA – 10

b) under all adjudications under the Construction Act as the only means of obtaining a stay in the adjudicator's decision?

Yes – 1 (2% of answers)

No – 44 (98% of answers)

NA – 10

c) only in adjudications under the Scheme and in cases where the parties have agreed to the use of a trustee stakeholder account for adjudicators award (as we have proposed)?

Yes – 5 (11% of answers)

No – 40 (89% of answers)

NA – 10

d) Other (please explain)?

Yes – 3 (7% of answers)

No – 42 (93% of answers)

NA – 10

Respondents suggested that the adjudicator could have the power to agree this approach with the parties after the dispute is referred or that the parties should have the power to agree this approach for insolvency in the contract.

Alternatively, do you believe that:

e) stays in an adjudicator's decisions should only be available through the courts?

Yes – 23 (51% of answers)

No – 22 (49% of answers)

NA – 10

f) stays in adjudicator's decisions should not be available at all?

Yes – 9 (20% of answers)

No – 36 (80% of answers)

NA – 10

Q10(ii) How often do you believe construction contracts contain clauses requiring adjudicator's decisions be paid into trustee stakeholder accounts?

a) More than one contract in 10? – 3

b) Between one contract in 10 and one in 100? – 12

c) Fewer than one contract in 100? – 18

No answer – **22**

Based upon this feedback it seems the use of these clauses is relatively rare at perhaps one contract in 100.

Q10(iii) How often do you believe these clauses result in a party deciding against referring a dispute to adjudication where it would otherwise have been referred?

a) More than half of disputes? – 11

b) About half of disputes? – 4

c) Fewer than half of disputes? – 15

No answer – **25**

Views are clearly somewhat polarised on this question.

Q10(iv) How often do you believe an award is made at adjudication where the receiving party is in insolvency proceedings?

a) More than one adjudication in 10? – 0

b) Between one adjudication in 10 and one in 100? – 13

c) Fewer than one adjudication in 100? – 24

No answer – **18**

It appears that perhaps only one adjudication in 100 is affected in this way.

Q11.1 Do you believe an adjudicator should have...

a) no power to make a final and binding decision of his jurisdiction? – 20

b) power to make a final and binding decision of his jurisdiction only in certain areas? – 14

c) power to make a final and binding decision of his jurisdiction in any area? – 14

no answer – **7**

Views were clearly divided on this question though it appears a slim majority of respondents were in favour of adjudicators having some discretion over their jurisdiction.

Q11.2 Do you agree with the principle that an adjudicator should only have the responsibility to make binding decisions in response to jurisdictional challenges in areas where there can be confidence in his ability to make a correct and reliable decision?

Yes – 31 (72% of answers)

No – 12 (28% of answers)

NA – 12

Some respondents seemed concerned that we might be proposing a statutory test to identify those areas where there could be confidence in the adjudicator's ability to determine his jurisdiction. We were actually seeking to identify a test which, from a policy perspective, would suggest areas where adjudicators might have discretion over their jurisdiction.

Q11.3 If you agree with the principle in Q11.2 do you agree that adjudicators could be expected to make correct and reliable decisions on the following grounds:

a) whether there is a construction contract for the purposes of Sections 104 and 105 of the Construction Act?

Yes – 35 (83% of answers)

No – 7 (17% of answers)

NA – 13

b) whether there is a dispute?

Yes – 34 (81% of answers)

No – 8 (19% of answers)

NA – 13

c) whether the adjudicator was properly appointed?

Yes – 35 (83% of answers)

No – 7 (17% of answers)

NA – 13

Q11.6 Do you believe that the legislation should provide the adjudicator with a statutory right to payment in any of the following circumstances:

a) when standing down after deciding he does not have jurisdiction?

Yes – 39 (91% of answers)

No – 4 (9% of answers)

NA – 12

b) when standing down after making a binding decision that he does not have jurisdiction under the proposal?

Yes – 32 (70% of answers)

No – 8 (30% of answers)

NA – 15

c) When standing down with the agreement of both parties to the contract (as at present)?

Yes – 38 (88% of answers)

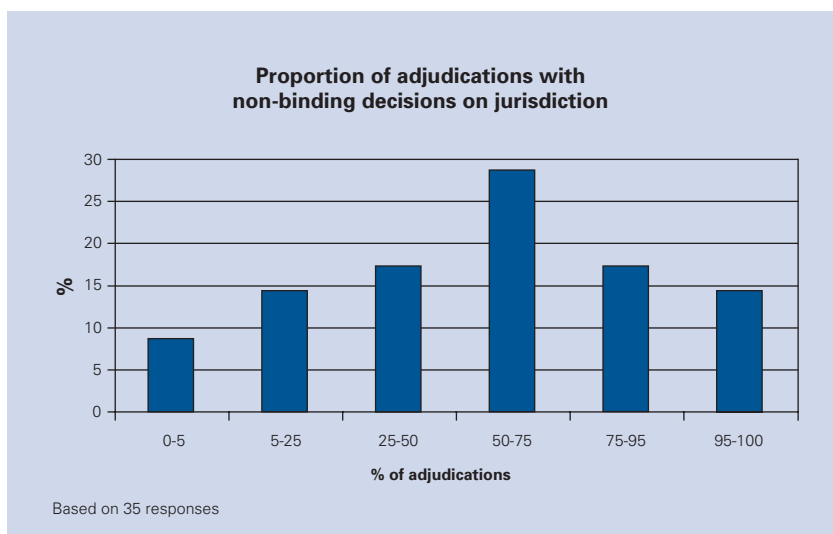
No – 5 (12% of answers)

NA – 12

This was another question where respondents often approved more than one of the options available. For this reason we have counted responses approving each option separately.

Q11(i) How often do you believe adjudicators make non-binding decisions as to their jurisdiction?

Answers are illustrated in the graph below.



Mean – 54%

Median – 62.5%

Mode – 62.5%

Based on this response, it seems reasonable to conclude that adjudicators make a non-binding decision of their jurisdiction in perhaps 60% of adjudications.

- Q11(ii)** How often do you believe a jurisdictional challenge relates largely to:
- Whether there is a construction contract for the purposes of Sections 104 and 105 of the Construction Act;
 - Whether there is a dispute; and,
 - Whether the adjudicator was properly appointed;
- a)** More than half of jurisdictional challenges – **12**
b) About half of jurisdictional challenges – **10**
c) Fewer than half of jurisdictional challenges – **6**
No answer – **27**

Some respondents suggested it is now very common to challenge jurisdiction based upon the argument that the contract was not properly evidenced in writing.

- Q11(vi)** What do you believe to be the average total cost of enforcement proceedings to the parties? (£)
- Mean – £13,000**
Median – £6,000

These answers use the same methodology as for Q2(i) by only considering the answers from the 7 respondents who submitted specific figures. However, a further 20 respondents suggested ranges of costs. Taking the midpoints of each range in addition to the 7 answers analysed above gives:

Mean – £13,000
Median – £12,500

Both methodologies also give the same:

Mode – £5,000.

This suggests that, though most enforcements cost less than £12,500, some can cost considerably more and push up the average price.

- Q12.2** Do you agree that unless a decision is of substance to a non-interim payment, the interim payment resulting from an adjudicator's decision could be revised in a subsequent payment or in the final account?

Yes – 28 (85% of answers)

No – 5 (15% of answers)

NA – 22

Are there any circumstances in which this might not be the case?

Yes – 7 (58% of answers)

No – 5 (42% of answers)

NA – 43

This question prompted a range of responses. Some respondents were unclear about what it meant for a decision to be of substance to the final account where another is not.

Q12.3 Do you agree that the legislation should...

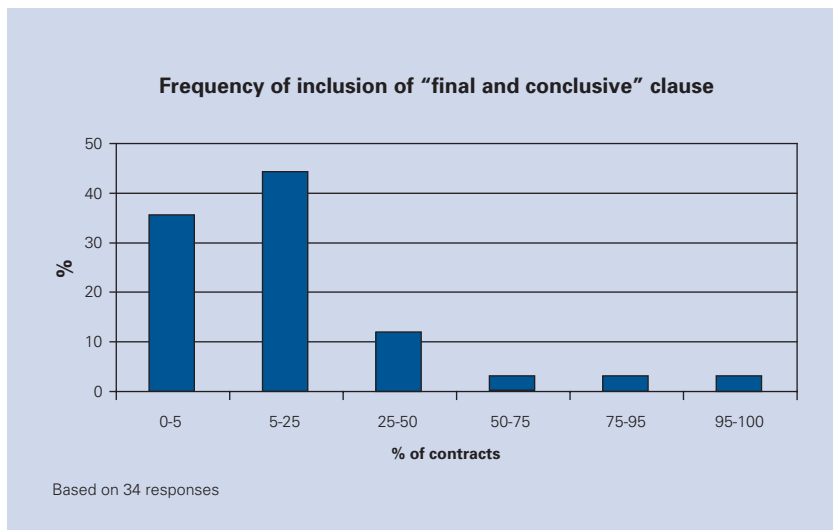
a) allow adjudicators in all adjudications to open up decisions or certificates which are of substance to interim payments? – **28**

b) leave the matter to the contract between the parties as at present with the current provision in the Scheme allowing the adjudicator to open up only decisions and certificates that are not final and conclusive? – **10**

no answer – **17**

Q12(i) How often do you believe contracts include clauses making decisions or certificates “final and conclusive” of matters that are only of substance to interim payments?

Answers are illustrated in the graph below.



Mean – 19%

Median – 15%

Mode – 15%

It appears that possibly 15% of contracts contain clauses of this kind.

Q13.1 Do you agree that the adjudicator should be provided with statutory immunity, as is provided to arbitrators by Section 29 of the Arbitration Act 1996 in place of the current requirement for contractual immunity in Section 108(4) of the Construction Act?

Yes – 40 (93% of answers)

No – 3 (7% of answers)

NA – 12

Q13.2 Are you aware of instances where the possibility of a third party claim against an adjudicator has had an adverse effect on the adjudication?

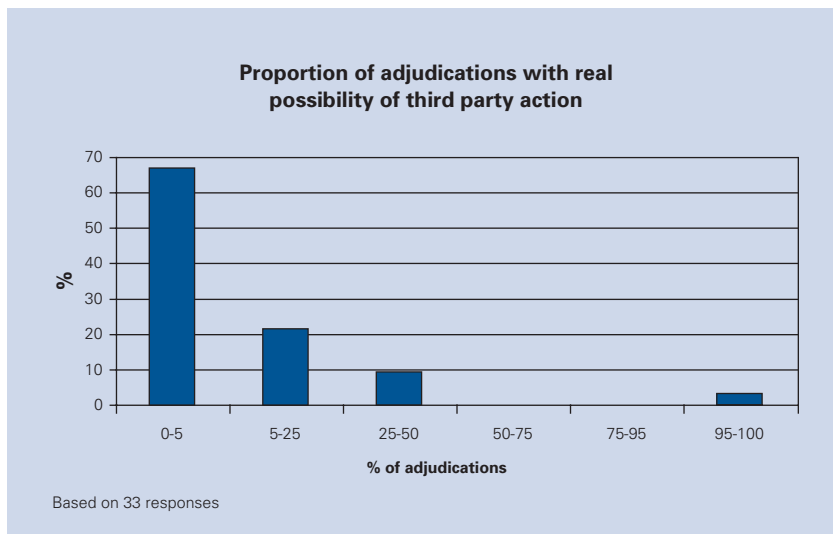
Yes – 3 (9% of answers)

No – 32 (91% of answers)

NA – 20

Q13(i) How often do you believe an adjudication results in a real possibility that an action could be brought by a third party (irrespective of whether such an action is brought)?

Answers are illustrated in the graph below.



Mean – 8.5%

Median – 2.5%

Mode – 2.5%

It appears there may be such a possibility approximately 5% of the time.

Q14.1 Do you agree with the proposed amendment to replicate the Scheme test of independence in the Construction Act?

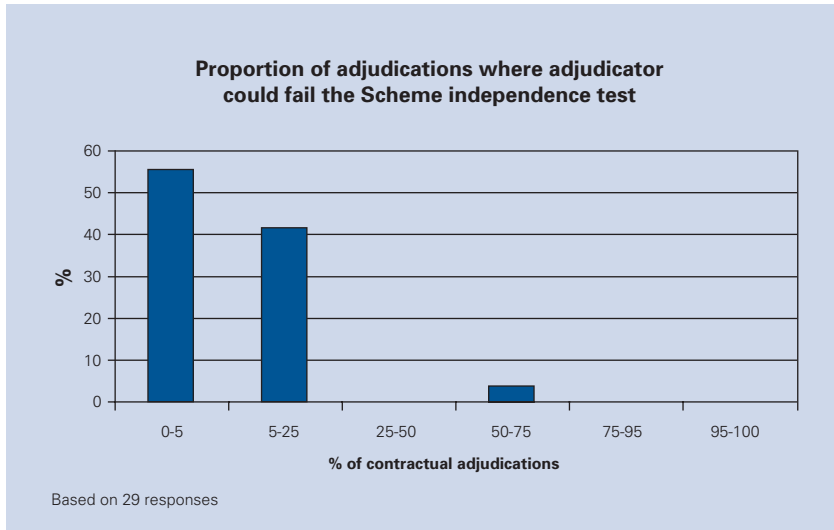
Yes – 40 (93% of answers)

No – 3 (7% of answers)

NA – 12

Q14(i) How often do you believe adjudications are conducted where the adjudicator would fail the requirement for independence in the Scheme for Construction Contracts?

Answers are illustrated in the graph below.



Mean – 10%

Median – 2.5%

Mode – 2.5%

It appears this could happen approximately 5% of the time.



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