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WILL THE CONSTRUCTION CONTRACTS BILL IMPROVE SUBCONTRACTOR CASH-FLOW?

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Background

‘There must be cash flow in the building trade - it is the very lifeblood of the enterprise’. Lord Denning, Master of the Rolls *Gilbert Ash (Northern) Ltd v. Modern Engineering (Bristol) Ltd* (1973).

Cash-flow is very important to any construction business and its effective management is a key function of quantity surveyors, particularly those working in the contracting sector. Businesses are going concerns and must generate sufficient incomes to meet their outgoings. Planning, forecasting and controlling cash-flow is a vital aspect of operating a successful company.

Successful cash-flow management is challenging at the best of times, but takes on a heightened importance in times of economic difficulty. Irish contractors and subcontractors are currently experiencing unprecedented financial difficulties in the wake of the banking and property market collapse. These difficulties are compounded by the widespread practice of late and underpayment by employers at all levels within the Industry. Despite the introduction of prompt payment legislation in 1997 and 2002, the autumn 2012 Irish Small and Medium Enterprise Association (ISME) Credit Watch Survey reports that, on average, firms operating in the Construction Industry are currently kept waiting 75 days for payment. Payment delays not only result in increased financing costs to the affected firm, but may also cause liquidity problems. Occasionally a company that would otherwise be profitable becomes insolvent and fails because it simply runs out of cash and is unable to pay its debts when they fall due. The Construction Industry has a poor reputation for its high levels of insolvencies.

In an attempt to alleviate these difficulties and improve cash flow within the Industry, Senator Feargal Quinn introduced a Private Members Bill, The Construction Contracts Bill 2010, (The Bill) in the Seanad. This Bill is the first Private Members Bill to be presented to the Oireachtas in over fifty years and aims to tackle the issue of

non payment to construction contractors who have completed works by introducing statutory requirements regarding payments and providing for adjudication as a quicker mechanism for resolving payment disputes. The Bill has recently completed its second reading in the Dail where Minister of State Brian Hayes TD, stated that '*the Government is committed to protecting small building subcontractors that have been denied payment from bigger companies*'. (Houses of the Oireachtas, 2012a) The Bill has been referred to the Select Committee on Public Expenditure and Reform and an amended draft originally scheduled to be published in autumn 2012 is due in the near future.

Quantity surveyors are expected to administer contracts in a fair and professional manner by clients, colleagues and contractors. Best practice holds that interim certificates should be carried out promptly and as accurately as possible. This will ensure that contractors and subcontractors are properly paid, thereby minimising cash-flow difficulties. The surveyor plays a key role in this process by evaluating and recommending how much money is to be paid. It is essential that they are competent in effectively administering the contract. Failure to carry out this duty or to execute their role in an impartial manner not only damages professional reputations but may also be breach their contract terms which may lead to legal action for damages.

Scope

As the Bill has been introduced primarily to address the issue of non payment of subcontractors, it is considered appropriate to examine the problem from the subcontractor's perspective. The study does not address, in depth, the related topic of main contractor payment which has been examined by McCaul (2011). Nor does it examine the various matters which give rise to disputes which may delay payment to subcontractors such as contracharges, below cost tendering, onerous contract conditions, and risk allocation. The study focuses on payment arrangements under typical subcontract conditions in Ireland and is framed in the context of a traditionally procured building contract arrangement where the design is provided by the employer. The related area of dispute resolution is outlined but not examined in depth due to scope limitations.

Aims and Objectives

This study investigates whether the proposed legislation will improve payment practice and the ease cash-flow pressures among those engaged in the Industry. In view of the lack of success of previous legislation to resolve this problem, the hypothesis, therefore, is that the proposed legislation will have little effect in resolving subcontractor cash-flow problems. The author's opening statement is:

The proposed legislation make little difference to the current situation!

This cynicism is prompted by the apparent failure of previous legislation in this area to have a noticeable effect. It is proposed, therefore, that this study is relevant, timely and topical.

The following objectives have been identified in order to achieve this aim:

- to examine the importance of cash-flow to contracting companies;
- to describe subcontract payment arrangements currently being operated;
- to report on cash-flow difficulties being experienced within the Industry;
- to describe and analyse the payment provisions of the Construction Contracts Bill 2010; and
- to investigate expectations and attitudes towards the proposed legislation.

The Literature Review

This Literature Review commences with an outline discussion of the importance of cash-flow to the smooth running of construction contracts. It outlines the right to payment under contract law and describes the various methods by which payment is made. It explains the administrative procedures and components of the payments clauses of published standard forms of subcontract for use with the Royal Institute of Architects in Ireland (RIAI). It reports the cash-flow difficulties currently being experienced within the Industry. It sets out the provisions of the *Construction Contracts Bill 2010* and reviews the expectations of what it may achieve and attitudes towards its introduction.

The Importance of Cash Flow

Cash flow may be defined as *'the movement of money in and out of the firm'*. Consequently, payments made for contract work represent negative cash flow (money out) for the client and positive cash flow (money in) for the contractor. (Cooke and Williams, 2009).

The practice of paying contractors regular interim payments is a notable characteristic of the Construction Industry. Historically this practice was developed by clients in order to fund substantial construction projects which would have represented a large percentage of many contractors' annual turnover and which, therefore, may have been beyond their capability to undertake. This arrangement eliminated the need for contractors to hold large reserves of working capital and the approach is typically now used on all but the smallest of building contracts. (Murdoch and Hughes, 2008)

Construction, nevertheless, is a credit-based industry and clients typically pay for work in arrears. Most construction contracts require contractors to carry out a month's work before applying for payment. This period is followed by a period of checking, certification and payment which varies depending on the form of contract employed. Contractors, in turn, expect even better credit facilities from their subcontractors and suppliers in order to reduce the negative cash flow effect of these deferred payments. (Cooke and Williams, 2009) This time lag between carrying out the work and being paid for it may extend to between 60 to 90 days and beyond. Money held back is effectively capital lock-up and this must, in turn be financed, generating interest payments. This adds to the cost of building and is counter-productive from a client-value point of view.

For most contractors interim certificates form their only source of income, from which they must fund the whole of their building operation, including paying wages, materials and subcontractors. They depend on full and timely payments to operate their business effectively. (Walker and Wilkie, 2002) The effect of late or underpayment may range from causing inconvenience to creating major difficulties. Where this occurs on a number of separate projects the cumulative effects may be catastrophic and may force company insolvency.

A further complication arises due to the structure of the Construction Industry which is organised in a complex network of interlinked and interdependent contractual

relationships, referred to as the supply chain. Subcontractors, particularly domestic subcontractors, are particularly vulnerable as they typically operate on pay-when-paid or extended credit arrangements. In these circumstances it is not difficult to envisage situations where the disruption of cash-flow at the head of the supply chain has disastrous knock-on effects for downstream subcontractors and suppliers and, which in turn, may have equally catastrophic rebound consequences for upstream larger contractors who remain ultimately responsible for delivering the works as originally agreed.

The Latham Report, *Constructing the Team*, stated that ‘*it is absolutely fundamental to trust within the construction industry that participants should be paid for the work which they have undertaken*’: (1994, p.93). and urged participants to trade fairly, particularly in relation to payments and related issues. The Report, referring to a survey carried out by a national contractor, identified a number of payment-related issues that were creating concerns for subcontractors. The survey revealed that factors such as the Industry’s “macho culture” and “screw the subbie” attitude were undermining performance levels. Cooke and Williams (2009) concur and identify an industry culture of late payment of subcontractors and suppliers who are commonly kept waiting for 60 or 90 days and may be forced to suspend supplies or even withdraw credit facilities. Failure to pay contractors on time or in full, therefore, is one of the main causes of friction affecting working relationships on site, creating unnecessary strain and frustration, and destroying goodwill in the process. This is counterproductive. It wastes money, and may ultimately require legal action to resolve disputes or to recover outstanding debts. Such situation may persist for years.

Proper cash-flow distribution throughout the supply chain appears, therefore, to be not just a desirable attribute, but an essential component and process within an effective construction industry and for the smooth operation of contracts.

2.2 Managing Cash-flow

The Contractor’s Perspective

Cooke and Williams (2009) note that main contractors rely on interim payments to pay wages, materials and subcontractors. Figure 2.1 illustrates the standard payment terms under the current RIAI form of contract, which shows that contractors typically wait upwards of six weeks to be paid. Under the Public Works Contract the payment

terms are significantly longer with a 10 working day certification and 15 working day honouring period: A typical payment under this contract may take a further three weeks to process.

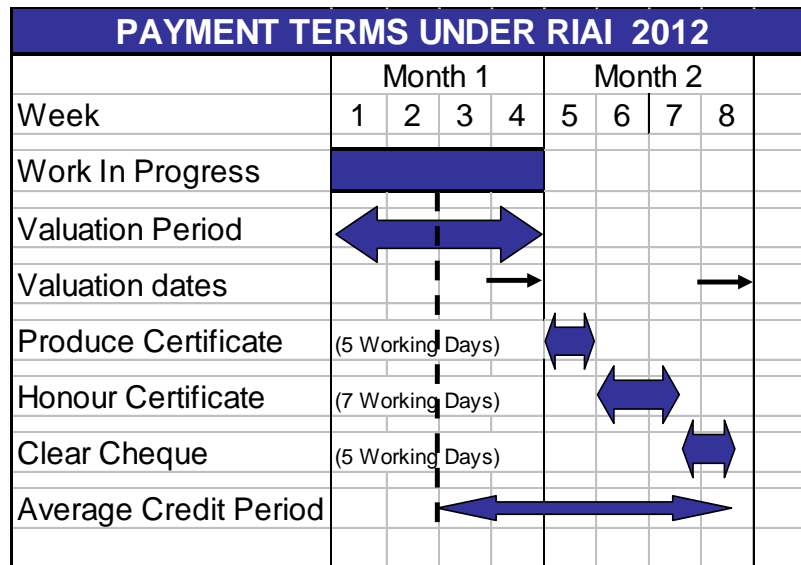


Figure 2.1 Payment Terms under the RIAI Form of Contract (Adapted Cooke and Williams, 2009)

This arrangement produces the typical ‘saw tooth’ cash-flow profile illustrated in Figure 2.2, which shows that the contractor is in a negative cash position for much, if not all, of the contract period. Contractors must fund the negative cash-flow from working capital and/or overdraft facilities, leaving them vulnerable to liquidity problems should the overdraft facility be reduced or withdrawn.

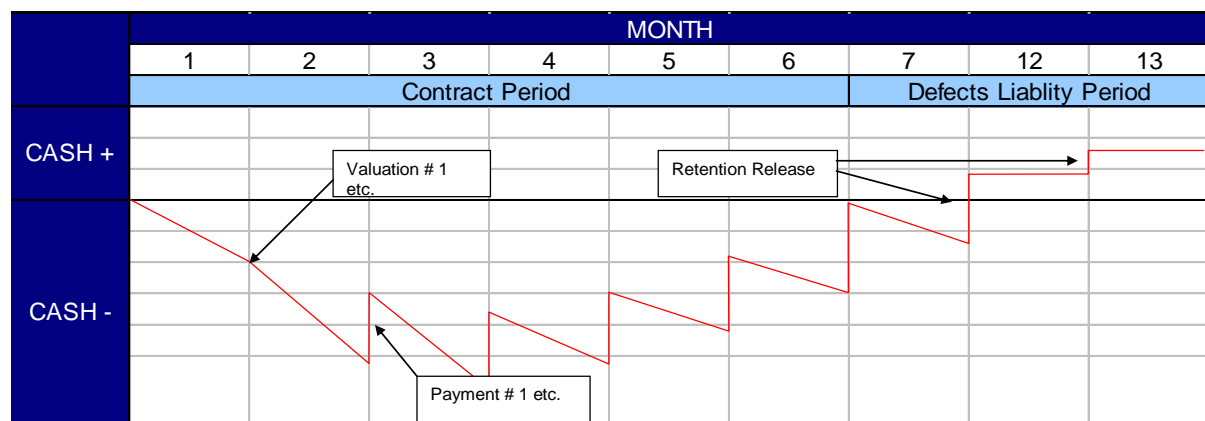


Figure 2.2 Typical Contract Cash Flow Profile (Adapted from Cooke and Williams 2009)

Contractors, however, typically do not pay subcontractors until they are paid by their clients. Material suppliers are generally paid 30 days from the end of the month of delivery. Plant hire companies usually invoice when the plant has been off-hired from site, and payment is normally due a month later. These arrangements produce a very

different cash-flow profile which is illustrated in Figure 2.3, showing that the project becomes self financing at an early stage of the project. This effect can be amplified by negotiating longer credit terms with the supply chain. Cooke and Williams (2009) suggest that as a rule of thumb a one month delay in paying creditors improves cash-flow by approximately 50%; the longer the deferral, the better the cash-flow. They comment that managing this delicate process of waiting for payment while delaying payment down the supply chain as having become somewhat of an ‘art form’ within the industry. Contractors, nevertheless, need to be careful that suppliers and subcontractors do not become frustrated and withdraw discounts and/or credit facilities or commence proceedings to recover debts.

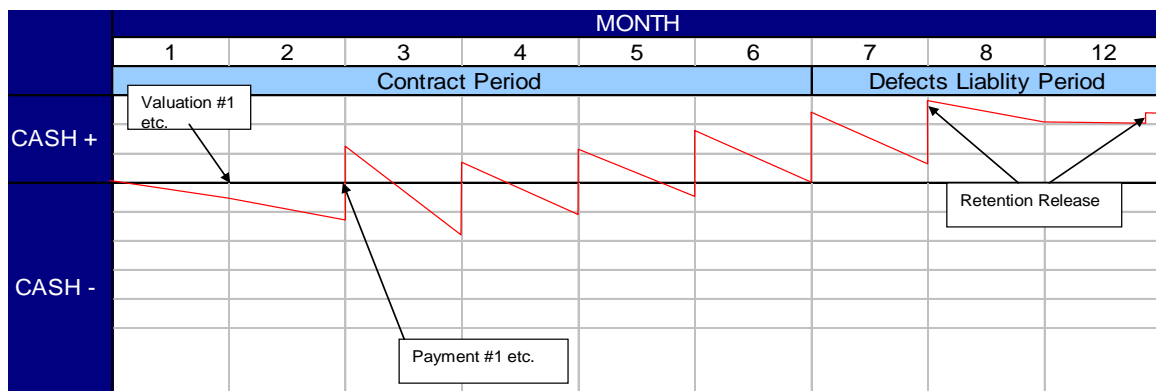


Figure 2.3 Typical Main Contractor's Cash Flow Profile (Adapted from Cooke and Williams 2009)

The Sub-Contractor's Perspective

The Subcontractor is typically paid for work in arrears and must finance this cost. A typical subcontract cash-flow is illustrated in Fig 2.4 below. This diagram shows a three months work package at the start of the construction period. It can be seen that this subcontractor has completed the works package before the first of his three interim payments is made. In addition, the subcontractor is shown to experience negative cash-flow throughout the remaining construction period, only breaking even during the defects liability period, and finally returning a profit following the release of retention money at the final account stage. This long wait following the normal ‘get in and get out fast’ approach to building leaves many subcontractors with little bargaining power against a main contractor who then becomes a reluctant payer. Eaten bread is quickly forgotten and the subcontractor may be left in a precarious position as a result!

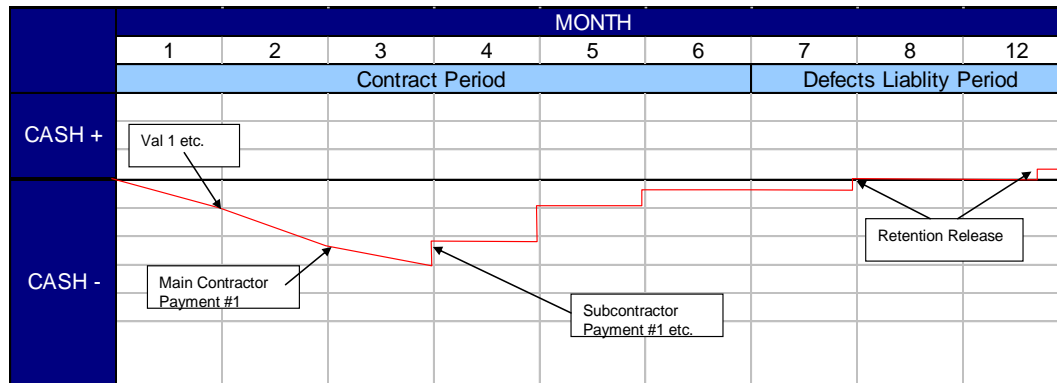


Figure 2.4 Typical Subcontractor's Cash Flow Profile

Serious problems may arise where small firms are squeezed between a main contractor and a supplier awaiting payment, with one controlling the money and the other controlling credit facilities for materials (Fryer, Egbu, Ellis and Gorse, 2004). This is the situation that the Bill sets out to address.

Payment Arrangements for Building Work

Many instances of late payment or underpayment on construction projects arise as a result of a dispute over how the work should be paid for. It is considered beneficial therefore to outline the principles underlining payment arrangements in construction contracts.

Murdoch and Hughes (2008) contend that the employer's primary contractual obligation is to pay the contractor. They advise that the contractor should be paid promptly and fully unless there are valid contractual reasons for withholding part of the payment. Keane (2001) notes that under the RIAI Standard Form of Contract '*The employer must honour the Certificate within seven days of presentation. Failure to do so is a ground for the Contractor to determine his own employment under the contract*' (p. 267).

Furst and Ramsey (2001) point out that payment arrangements are governed by the terms of the specific contract and that the parties can agree whatever payment arrangements they please provided they are legal. They identify three broad categories under which the right to payment may arise: lump-sum contracts; contracts other than lump-sum and quantum meruit.

A *Lump sum contract* is a contract to complete a whole work for a lump sum, for example, to build a house for €200,000. In these contracts the contract sum is

determined before construction starts, and this amount is entered in the agreement. The RIAI Standard Form of Building Contract 2012 is an example of a standard form of lump sum building contract.

A contract may be worded in such a manner that it may be described as an *entire* contract, i.e. that complete performance is a *condition precedent* to the obligation of the employer to pay anything at all. These would normally be confined to small domestic or residential contracts, but they are frequently encountered on subcontracts.

Generally, however, the contract will provide for the right to payments as the work proceeds. Contracts also typically operate according to the principle of *substantial performance* where the contractor will be entitled to payment even if the work contains some defects or minor omissions which may be set off against full payment. In addition variations are normally ordered during the progress of the works, which will give rise to adjustments to the contract sum. The actual final account payable will therefore often be very different from the original lump sum stated. But the principle of payment remains that the lump sum is adjusted: the actual work is not remeasured and repriced according to the contract rates.

Contracts other than for a lump sum are usually categorised as either measure and value contracts or cost reimbursement contracts. A *Measured contract* is where the contract sum is accurately known only on completion, and after remeasurement on some agreed basis. An example of a re-measured contract in Ireland is the Institute of Engineers in Ireland (IEI) Contract. Here the actual work done is measured and valued according to a schedule of rates or in a manner laid down in the contract. Bills of quantities, where used on these contracts provide a schedule of rates and units of measurement which define the work for which that sum is payable.

Cost reimbursement contracts: often referred to as ‘dayworks’ is where the contract sum is arrived at on the basis of the actual costs of labour, plant and materials, to which is added a fee to cover overheads and profit. This arrangement makes the Employer particularly dependent on the integrity, reliability and efficiency of the Contractor. There is no standard form of cost plus contract published in the Republic of Ireland.

In certain circumstances the value of work may be determined on the basis of *Quantum Meruit*. This Latin term means ‘the amount he deserves’ or ‘ what the job is

worth' and denotes a basis for payment whereby the Contractor is paid a reasonable amount for the completed work. It is frequently used where there the arrangement does not provide for how the work is to be paid. (Furst and Ramsay, 2001)

Although many 'traditional' standard forms of contract are described as lump sum contracts and the sum is agreed in advanced, it is rare for a contract to be paid exclusively by one method and that usually lump sum, measurement and reimbursement methods of payment are combined within the individual contract.

The Late Payment in Commercial Transactions Regulations 2002.

The Late Payment in Commercial Transactions Regulations 2002 supersede the Prompt Payment of Accounts Act 1997 which introduced legislation to ensure timely payment but which was limited to public sector contracts. The 2002 Regulations stipulate that, in the absence of agreed contracts terms, payment arrangements are subject to the Regulations which apply to both public and private sector *commercial* transactions. Debts related to other laws such as insolvency law, interest claims for less than five euro and consumer transactions are not governed by the Regulations. The Regulations provide that unless otherwise agreed payments outstanding after 30 days will attract interest at the European Central Bank Rate seven percentage points. As of the 1st January 2013 the late payment rate of interest is 7.75%

The then Department of Trade, Enterprise and Employment (now Jobs, Enterprise and Innovation) claimed that the enactment of the Prompt Payment of Accounts Act 1997 substantially improved payment times in the public sector and that the average payment time was then 51 days. Commenting on the effectiveness of the 2002 legislation, Mark Fielding, the Chief executive of ISME, stated that it is '*working against small business and that the New EU Directive due to be transposed into Irish law in March [2013] will exacerbate the situation.*' He added

We are telling the EU Commission, here today, and our own Government that their efforts on late payments have not worked for Ireland and in fact have exacerbated the situation by allowing big business and Government agencies to contract out of the legislation, thereby abusing their dominant positions. The figures prove it. The average credit period in 2002 was 52 days, today, after 11 years of legislation, it is 71 days

The new 'sticking plaster' Directive is not only ineffective, it is downright madness, as it will enshrine 60 days rather than 30 days into legislation

It is clear from the quarterly ISME Credit Watch Surveys that there is widespread frustration among the small business community that statutory requirements are being flouted. The Regulations contain no enforcement mechanisms and small businesses appear to be very reluctant to resort to legal action against their clients in order to recover debts.

Standard Forms of Contract

It is normal practice for substantial building contracts to be let on the basis of standard forms of contract. Murdoch and Hughes, (2008) comment that these offer a number of benefits in that typically they are negotiated by the various stakeholder representative bodies to allocate an equitable distribution of risk, and allow participants to become familiar with the contracts provisions. The Latham Report (1994) recommends that standard forms should be used without alterations. Amendments may upset the balance of the forms and the resulting meaning of the conditions could be disputed. Nevertheless standard forms of contract and subcontracts are now widely amended to remove areas of risk from their Employers. Occasionally standard forms of building contract may not fit the client's requirements and a specially drafted agreement may be needed. There is an increasing trend towards non-standard agreements particularly in the case of multi national companies.

The most widely used forms of main contract in Ireland are the RIAI contract for private sector projects and the GCCC contract for public sector contracts. In addition there are a number of published subcontract forms for use on building contracts which include:

- The Construction Industry Federation and the Sub-Contractors and Specialist Association Sub Contract (SCSA) (1989) which is discussed below.
- The Specialist Contract Document (1999) This contract is published by the CIF and is reported to be used on approximately 25% of subcontract, however contractors are reluctant to use it as it does not operate on a pay when paid basis. (CIF, reported in Bowen 2007)
- The CIF Sub-Contract for use with the PublicWorks Contract entitled "Agreement and Conditions of Sub-Contract for use in Conjunction with the Forms of Main Contract for Public Works issued by the Department of Finance 2007" and was

published in May 2008. This new sub-contract will compliment the new NN Specialist Contract where specialists are pre-selected by the Employer and are named in the tender documents by the Employer when selecting the Main Contractor.

- Other standard forms of contract or imported forms of subcontract such as the UK Dom 1 and Dom 2

It is suspected, however that a significant percentage, if not most, subcontracts on substantial projects are agreed on the main contractors standard terms of business and it also claimed that many subcontracts are arranged informally and key terms such as payment arrangements and dispute resolution are not agreed.

The Construction Industry Federation and the Sub-Contractors and Specialist Association Sub Contract (1989)

This sub-contract, commonly referred to as the ‘White Form’ (The Form) is the most widely used standard form of sub-contract for private sector contracts in Ireland and is designed to be used with the RIAI form of main contract. It is approved by the CIF and SCSA representing both main contractors’ and sub-contractors’ interests. The Form is more commonly used on nominated subcontracts than on domestic subcontracts, however its use has been commended for domestic subcontracts by Kenny J. in *Murphy Brothers (Dublin) Limited v. Morris*. The Form contains detailed provisions regarding payments, insurance, defects, variations, main contractor’s attendance, determination of the contract, and wage and price variations. The most relevant provisions relating to this study dealing with payment and set-off and are contained in Clauses 11 and 13 of the Form. The main points of these clauses are discussed below. Disputes arising under the Sub-Contract may be resolved by the arbitration procedures set out in Clause 26 of the Form.

Clause 11 Payment

Clause 11 (a) provides that the Contractor shall apply for payment on behalf of the Sub-Contractor. Such applications shall include the value of varied work and materials on site and shall be made not later than thirty days after receipt of the Sub-Contractor’s detailed progress statement. The Contractor shall also give the Sub-

Contractor at least seven days notice prior to making an application for payment under the Main Contract.

Clause 11 (b) deals with interim payments to the Sub-Contractor. Payment is normally due to the Sub-Contractor fourteen days after the Contractor has received a Certificate from the Architect. The Contractor is entitled to hold the agreed retention amounts on the sub-contract. However, the Sub-Contractor undertakes that he will not take steps to enforce the payment until seven days after the Main Contractor has actually received payment under the Certificate in question. This, therefore amounts to a “pay when paid” form of sub-contract. The provision permitting the Contractor a cash discount of 5% for prompt payment within seven days has been removed from the 2012 revision of the RIAI Contract and is, therefore, no longer applicable to this Sub Contract.

Clauses 11 (c) and (d) provide that the Main Contractor is to furnish, on demand by the Sub-Contractor, details of the amounts included for the subcontract works in the Architect’s Certificates and that payments in respect of the Sub-Contract works made to the Contractor are to be held in trust for the Sub-Contractor.

Sub-clause 11(e) deals with non payment by the Contractor and sets out three remedies for the Sub-Contractor. The Sub-Contractor may:

- (a) apply directly to the Employer for payment if the Contractor does not pay the certified amounts within seven days of receiving payment or within 14 days from the issue of the Architect’s Certificate, and the Employer may set off such amounts against further payment due to the Contractor.
- (b) subject to seven days notice, suspend the works for fourteen days if payment is not made within seven days of the Contractor being paid or within 28 days from the issue of the Architect’s Certificate, and in the event of continuing default, subsequently determine his own employment.
- (c) charge interest on outstanding amounts if not paid within 28 days from the issue of the Architect’s Certificate.

It should be noted that the entitlement to seek information directly from the Architect or Engineer under sub-clause 11(c) and to obtain payment directly from the Employer under sub-clause 11(e) is usually limited to nominated subcontracts or to sub-contracts where there is a collateral warranty between the sub-contractor and the

Employer. The RIAI Form of Contract provides that nominated subcontractors *may* be paid directly by the Employer in the event that the Main Contractor fails to make such payments. No such protection is provided to domestic subcontractors under the RIAI Form.

Sub-clause (e) deals with disputes as to Certificates on nominated sub-contracts and provides that Contractor may join the Sub-Contractor as claimant in any legal proceedings where the Sub-Contractor is aggrieved by amounts certified by the Architect or failure by the Employer to honour a Certificate.

Clause 13 Set Off

Set off refers to the practice of counter-charging for loss and/or expense incurred as a result of failure to properly carry out the work; for example due to defects under Clause 9(a), delay and/or disruption under Clause 7(a), site cleaning etc. against sums otherwise due for completed work. Few issues cause as much trouble on site as resolving these matters. The terms of the Sub-Contract Form allow a restricted set-off.

Clause 13(1) provides that the Contractor may deduct any amount *agreed by the subcontractor* as due to the Contractor, or *awarded in arbitration or litigation* from money otherwise due under the sub-contract,

Clause 13(2) states that the Contractor may set-off any claim for *loss and/or expense* incurred due to *breach of, or failure to observe the provisions of the sub-contract*, by the Sub-Contractor, provided that:

- (a) the set-off amount is quantified in detail and with reasonable accuracy by the Contractor, and
- (b) the Contractor notifies the Sub-Contractor in writing, at least 17 days before the payment becomes due, of his intention to set-off the above amount specifying the grounds for the deduction.

Clause 13(3) states that any such set-off is without prejudice to the rights of the Contractor or Sub-Contractor in subsequent proceedings.

Clause 13(4) states “ *the rights of the parties to this subcontract in respect of set-off are fully set out in these conditions and no other rights whatsoever shall be implied as terms of this subcontract relating to set-off.*”

While the White Form seeks to achieve a balance between the main contracting and subcontracting sectors, in practice payment problems are still common. Established approaches to procurement, management of materials supply contracts and subcontracting are generally based on aggressive bargaining between buyer and supplier over issues of price, delivery date and payment date, conducted in an atmosphere of legalistic mistrust (Latham, 1994; Egan, 1998). Two of the main problems with the sub-contractor payment, *pay when paid* and *set-off cross claims* are prominent features of this Subcontract. The *Latham Report* and the *1997 Strategic Review of the Construction Industry* have recommended that pay when paid clauses should be prohibited. The problems arising from situations where the employer is entitled to refuse payment to the main contractor where the sub-contractor is blameless usually goes unaddressed. Similarly it is easy to envisage situations where an unscrupulous main contractor could levy fines and counter-charges against a subcontractor who has little option other than putting up with them.

Delay and Undervaluation of Subcontractor Payments

A key objective of this study is to investigate cash-flow difficulties being experienced by subcontractors due to non-payment on time or in full. Subcontractors should be paid in accordance with the terms of their contract. These may be:

- within a certain time, stated in the particular contract, after their application for payment;
- within a certain time, stated in the particular contract, after the main contractor has been paid – the pay when paid clause; or
- within thirty days of application in accordance with the Prompt Payment of Accounts Act 2002.

It is clear that in many cases these requirements are not being complied with and that cash-flow is disrupted as a result.

It is also important to establish whether a payment is undervalued. Unresolved payment claims may develop into disputes which typically fall into two categories:

- Those in which the debt is not disputed; and
- Those in which the debt is disputed.

Where the debt is not disputed the subcontractor must either wait or take action to recover the money. The response varies from chasing the payment more vigorously, improving credit management systems to the use of debt recovery agencies or legal action. Delaney (cited in Bowen 2007) identifies inadequate response to late payment as a key factor in perpetuating the culture of late payment. He claimed that inadequate credit management policies and overly defensive attitudes are significant weaknesses in many construction firms. This aspect was also commented on by a CIF spokesman (reported in Bowen, 2007) who observed that acquiescing in late payment indicates to main contractors that this practice is acceptable. He viewed this as a lack of professionalism on both sides with the subcontractor displaying poor debt management skills and the main contractor abusing his dominant position. Bowen's study also reported the experience of a Prominent Chartered QS who remarked that payment delays were often due to ineffective contract administration and that subcontract payment applications were often submitted too late for inclusion in the main contractor's progress application or were sent to the wrong person, or indeed, the wrong place. Clearer communication is obviously required in these instances.

The reason for delayed payment is not always the subcontractor's fault. Perhaps the main contractor's quantity surveyor is too busy, or is not inclined to, or is incapable of processing the work within the deadlines. It may also be the policy of the company to optimise cash flow by delaying payment to downstream contractors – the so called reluctant payer.

The situation becomes more complicated where the payment amount is disputed. Disputes may arise over numerous matters relating to the amount of work completed and how it should be valued; this has been touched upon above. Disagreements are common over the evaluation of preliminaries, prime cost and provisional work, variations, material and labour price variation accounts, and prolongation and disruption claims. The actual cost of these variables can only be ascertained fully after the works have been carried out. In addition disputes may arise as a result of alleged defective work or failure to protect work. Counter charges for delaying or damaging other work may also be imposed.

The Adjudication Reporting Centre of Glasgow Caledonian University tabulated the primary subjects of disputes in the UK between the years 2004 and 2008. and is reported in the Regulatory Impact Appraisal (RIA) carried out by the Department of

Public Enterprise and Reform (DPER) following the passage of the Bill through the Seanad. Their findings are set out in figure 2.6

<u>Subject</u>	<u>2004</u>	<u>2005</u>	<u>2007</u>	<u>2008</u>
Valuation of Final Account	12%	14%	22%	22%
Failure to comply with Payment Provisions	19%	14%	8%	19%
Valuation of interim payments	15%	3%	15%	16%
Withholding monies	10%	11%	10%	10%
Extension of Time	8%	8%	8%	9%
Loss and Expense	9%	10%	2%	7%
Valuation of Variations	15%	17%	11%	5%
Defective Work	4%	5%	7%	4%
Determination	2%	3%	4%	4%
Non-payment of fees	2%	1%	7%	2%

Fig 2.6 Primary Subjects of Dispute in the UK (Source DPER, 2012)

It is clear that the valuation of the Final Account is the most common source of disputes submitted to adjudication in the UK. The RIA suggests that this may simply be due to the fact that most disputes are referred to adjudication following practical completion and would therefore inevitably impact on the Final Account. The Appraisal, nevertheless, identified that the vast majority of disputes were payment related. (DPER, 2011)

A particular effect of disputed payments which impacts on cash-flow is that claimants are rarely fully reimbursed for the cost of work pending the resolution of their dispute. Contractors typically adopt a cautious stance when estimating the value of disputed subcontract issues and are wary of the risk of overpaying for the work, which may subsequently prove to be difficult and embarrassing to recover. Disputes, nevertheless, must eventually be resolved and this often occurs during the final account phase after the project has been completed. Subcontractors who may already have waited a considerable amount of time may become impatient with a main contractor who delays and/or frustrates the agreement of outstanding accounts and be ‘forced to the table’ to accept a poor ‘final offer’ from a main contractor employing these tactics. It is likely that a quick means of resolving disputes would have a beneficial effect on cash-flow in such instances.

It is important, therefore, that the subcontractor submits clear, timely and accurate payment applications to enable the contractor’s quantity surveyor to process the application as quickly and easily as possible. The practice of overclaiming for work-

in-progress should also be avoided as the discovery of overpriced work may lead to unwarranted defensive cuts or the return of the application unprocessed.

One of the major dilemmas facing subcontractors is potential damage that might be caused to working relationships as a result of a more determined approach to debt recovery or threatening to take legal action. ISME (2013) commenting on current statutory payment provisions expresses this problem forcefully:

Allowing SMEs to charge 8% rather than 7% on late payment is a sick joke, as small businesses are already being told that they will lose business if they even attempt to charge the current rate. This market power and corresponding fear of harming commercial relationships is not being addressed by the new [EU] directive. Another example of 'being seen to do something'

This sentiment is echoed in Bowen (2007) where a research participant, a senior manager in a large contracting organisation, observed that '*generally contractors do not work with those subcontractors after legal action has been taken but there have been occasions in the past where the relationship can built up again.*' This seems to produce a situation of being damned if you do and damned if you don't. It seems clear that subcontractors need to be careful and that checks should be carried out on the main contractor's financial status and record of paying subcontractors before advancing or extending credit facilities. However, in the current climate these risks are often ignored in the struggle to obtain work.

The Construction Contracts Bill 2010

The Bill was introduced in the Seanad by Senator Feargal Quinn on 12th May 2010 against a backdrop of almost ten Construction Industry failures per week during 2009.

The Senator's objectives were to

“improve payment practices in the Construction Industry by providing clarity and transparency in the payment of monies due in construction contracts. This will improve crucial cash-flow to those sub-contractors working in the Industry, thus helping companies in the construction sector to survive and keep people in employment”. (Oireachtas, 2010)

Minister of State, Brian Hayes TD in moving the Second Stage of the Bill on 3rd May 2012 remarked that

“While there is strong anecdotal of the practice of delayed or non-payment having escalated in recent times, it should be noted that the problem is not new. It is reported that many firms, mainly subcontractors, are experiencing serious difficulty in obtaining payment for work done. It is therefore important that where possible, payment transactions within this sector should be

facilitated to ensure prompt payment of the correct amount". Oireachtas, 2012a)

The Minister described many construction contracts as being '*far too imprecise*' and not cost effective. The Bill provides statutory arrangements including interim payments to address the issue of non-payment to constructors who have properly completed their work. It also proposes adjudication to speed up dispute resolution procedures. These measures are designed to reduce the constructor's financial exposure to non-payment. The Minister acknowledged that the Bill cannot address many of the reasons for late or non-payment, particularly instances involving business failure and insolvency.

The Bill, contains twelve sections and one schedule and is attached as Appendix C. The Contents Page of the Bill is reproduced in Figure 2 5. This study focuses on the provisions relating to payment and cash flow contained in the Bill.



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Explanatory Memorandum](#)

**AN BILLE UM CHONARTHAÍ FOIRGNÍOCHT, 2010
CONSTRUCTION CONTRACTS BILL 2010**

*Mar a ritheadh ag Seanad Éireann
As passed by Seanad Éireann*

ARRANGEMENT OF SECTIONS

Section

1. Interpretation.
2. Construction contracts: exceptions, etc.
3. Payments under construction contracts.
4. Payment claim notices.
5. Right to suspend work for non-payment.
6. Right to refer payment disputes to adjudication.
7. Right to suspend work for failure to comply with adjudicator's decision.
8. Selection of panel of adjudicators.
9. Code of practice for adjudication.
10. Delivery of notices, etc.
11. Short title and commencement.

SCHEDULE

PROVISIONS TO APPLY TO MATTERS REGARDING PAYMENTS

Figure 2.5 Arrangement of Section Construction Contracts Bill 2010

Section 1 Interpretation

Section 1 of the Bill defines the terminology used. For example, 'construction operations' are widely interpreted and covers numerous diverse activities ranging from major civil engineering infrastructure projects to artistic works attached to real estate.

Section 2 Construction Contracts: Exceptions etc

Section 2 concerns the application of the Bill. Subsection (1) excludes a range of contracts which fall below certain value or area thresholds.

1. publicly funded contracts under €50,000 in value.
2. private owner-occupied dwellings over €200,000 in value provided these are less than 200 square metres in area
3. other contracts not exceeding €200,000 in value.

Public private partnerships are also excluded from the application of the Bill.

Section 3 Payment Provisions

Section 3 concerns payment provisions. Contracts covered by the Bill must:

1. identify either the amount of each interim payment and the final payment to be made under the contract, or provide an ‘adequate mechanism’ to establish these sums.
2. identify either the payment claim dates or an adequate mechanism to determine these and stipulate the maximum period in which these payments must be made.

Sections 3.3 and 3.4 concern the application of the Schedule. The Schedule applies to contracts which do not include the two provisions above. It also applies to subcontracts unless the particular subcontract contains more favourable credit terms for the subcontractor than those it provides for. The Schedule provides that payments claims be made 30 days after the commencement of the contract and at 30 day intervals thereafter until substantial completion is achieved: the final payment claim is to be made 30 days following final completion. On short duration contracts, not exceeding 45 days, the payment claim date is to be 14 days following completion of the work. Payments become due 30 days after the payment claim date.

Section 3.5 prohibits the use of ‘pay when paid’ except in limited circumstances set out in Sub-section 6 which involve various matters relating to insolvency.

Section 4 Payment Claim Notices

Section 4 details the procedures for claiming and making payment and provides the payer with the opportunity to set-off claims for loss/expense and damage from the payment claim made by the contractor. Under this Section the contractor or subcontractor, submits a *payment claim notice* specifying the amount claimed and provides supporting particulars within five days of the payment claim date to their employer. If the employer contests the claimed amount they must respond to the claimant within 21 days of the payment claim date specifying the payment amount proposed, the reasons for the difference and the related calculations.

If one or more of the reasons for the difference relate to claims to set off loss and/or expense due to alleged breach(es) of ‘*any contractual or other obligation of the executing party (under the construction contract or otherwise) or any other claim that the other person alleges against the executing party*’, the response must identify the basis, particulars and calculations for each such claim. If these matters are not settled by the date on which the amount is due, the employer is required to pay the claimed amount in full.

Section 5 Actions regarding non-payment

Section 5 of the Bill establishes a contractor’s right to suspend work for a period of up to fourteen days for non-payment in full by the due date. This right is subject to providing two written notices: the first not earlier than the day after payment was due and the second seven days prior to proposing to suspend the work, specifying the grounds for the threatened suspension. Work may not be suspended after payment has been received or following the end of the fourteen day suspension period. The contractor will be entitled to extra time to complete the works due to the suspension where this is accepted, or found to be, justified. No extension of time will be due on a main contract where the work is delayed because a subcontractor has suspended the work. In such cases, however, where justified, the subcontractor would be entitled to extra time.

Sections 6 to 11 Adjudication and Other Payment Related Matters

Of the remaining sections of the Bill, Sections 6 to 9 relate to the adjudication process which is establishes a right to refer payment disputes to adjudication; the right to

suspend works for failure to comply with an adjudicator's decision; the selection of a panel of adjudicators and the code of practice for adjudication. The main points of these sections relating to payments and cash-flow implications are outlined below. Sections 10 and 11 relate to delivery of notices, etc and the short title and commencement arrangements for the legislation respectively, these bear only marginal relevance to the study and are not examined in further detail.

Section 6 stipulates that a construction contract cannot be drafted to exclude recourse to adjudication and sets out the procedures for initiating and conducting the process. The appointment of the adjudicator may be agreed within five days of serving notice to proceed to adjudication or arrangements are commenced to appoint an adjudicator from a panel selected by the Minister. The payment dispute must be referred to the appointed adjudicator within seven days. The decision of the adjudicator is normally scheduled to be delivered within a 28 day period from referral. Sub-sections 11 and 12 provide that:-

(11) subject to subsection (12), the decision of the adjudicator shall be binding until the payment dispute is finally settled by the parties

(12) The decision of the adjudicator *shall not be binding if the payment dispute is referred to arbitrations or proceedings are otherwise initiated in relation to the decision* unless the parties agree to accept the decision as finally determining the payment dispute.

Each party bears his own costs and pays the adjudicator's cost in accordance with the decision. Failure to comply with an adjudicator's decision gives rise to grounds to suspend work. The procedures relating to suspending work echo the provisions of Section 5 discussed above.

Analysis of the Payment Provisions of the Bill

The principle objectives of Senator Quinn's Bill are to ensure prompt payment and to enable payment disputes to be resolved quickly and economically. The construction professions and industry representative bodies support the introduction of legislation to achieve these objectives. Nevertheless submissions by institutions such as the Society of Chartered Surveyors (SCSI) have concluded that the Bill, as currently drafted, fails to achieve the objectives, and could leave many contractors and subcontractors in a worse position than at present (SCSI, 2011)

The Regulatory Impact Appraisal (DPER, 2011) reported that most construction contracts are carried out on an informal basis with no written contract in place. There are no minimum standards in relation to payment and the timing of such payment. The sector is small which means that where there is a contract that the bulk of the power rests with the main contractor.

The RIA examined three potential outcomes: to do nothing; to enact the Bill as passed by the Seanad, and to consider possible amendments to the Bill. The Appraisal concluded that if nothing was done the status quo would persist, and the competitiveness and solvency of SMEs would be compromised. This was seen as a negative. The impact of enacting the un-amended Bill would incur small administrative costs but would provide a substantial benefit in furthering national competitiveness whilst safeguarding public money. The Appraisal also outlined a number of possible amendments to the Bill of which four were examined in some detail:

1. a requirement to establish a guarantee account;
2. reducing or removing the scope thresholds
3. temporary binding adjudication regardless of referral to arbitration
4. extending the scope to bespoke products manufactured for the project (DPER, 2011).

The Bill received its second stage reading in the Dail during May and June 2012. Forty nine deputies contributed to the debate, and while the Bill was unanimously welcomed, many of the deputies expressed regret that similar measures were not in place before the economic collapse. Many of contributors described the plight of small contractors in their constituencies and were angry that they had not paid by main contractors, particularly for work on public sector contracts. The speakers, in the main, supported the recommendations set out in the RIA. It was clear that they were particularly concerned over the application thresholds which were seen as being too high and contrary to the purpose and intent of the Bill. A number of deputies also called for the meaning of ‘bespoke products’ to be expanded to include materials such as concrete, blocks and general building supplies which could not be recovered once incorporated in the Works. These and other matters are examined in the following analysis of the payment provisions of the Bill.

Security of Payment

At present the Bill does not provide for establishing a ‘project bank account.’ The RIA comments that whilst the provision has its merits it would likely add a unwarranted regulatory imposition and increase construction costs. It argues that the cost of providing a bond at present could be high and might further deteriorate a smaller contractor’s cash flow thereby reducing competition and competitiveness. The Assessment records that there is little data on the extent of non payment within the industry and what information there is, is anecdotal in nature. The Appraisal questions whether the extent of the problem warrants insuring against it. The Appraisal proceeds to examine why exposure to non payment arises and indicates that frequently this is due to lack of formal contractual arrangements, absence of interim provisions and/or including pay when paid clauses in the contract and, the disincentive effect of expensive, time consuming dispute resolution procedures in obtaining full reimbursement. The Appraisal argues that Bill addresses the last three of these issues thereby reducing the exposure of subcontractors to non payment.

Deputy Mick Wallace provided a graphic illustration of a sub contractor’s exposure to risk of non payment by a main contractor. *‘As a subcontractor, I worked for one of the biggest builders in the country . . . I did £170,000 worth of work for him, labour only, and he gave me £150,000. I told him he still owed me £20,000 and he told me to go to hell, that he had given me enough’*. Deputy Wallace added that he was not alone in being treated in this manner and that he eventually recovered some of the money by another *‘unorthodox route’*. (Oireachtas, 2012a)

A number of deputies called for a means of ring fencing of money for sub contractors. For example, Deputy Mary Lou McDonald supported the call from the Mechanical and Electrical Contractors Associations for the inclusion of a trust clause. She reported the Association’s claim that the largest six main contractors that failed in the years 2010 and 2011 left unpaid debts of over €500 million. *‘On this basis, a statutory trust provision is required, as applies, for instance, under Canadian law. We must look at this issue of ring-fencing moneys paid by the payer to the payee for work completed by subcontractors.’* (Oireachtas 2012a)

The submission made by the Society of Chartered Surveyors in Ireland (SCSI) on the Bill in April 2012 argued that *‘without security of payment the point of this piece of*

legislation would be lost and the Bill would be utterly meaningless'. The Society observed that main contractors engaged on public sector contracts rarely have issues regarding security of payment. However they suggest that establishing a project account similar that provided for under the existing RIAI contracts could provide security through the supply chain by providing the ability to pay subcontractors directly. (SCSI, 2012)

McCaul (2011) reports a Prominent Chartered QS as believing that requirement to operate a security bank account would strengthen the current Bill. He referred to Senator Quinn's original objectives to free up payments by ensuring '*timely payment, . . . the size of the payment, . . . enforcement of entitlements and . . . the money is there. Now that is not in the Contracts Bill at the moment. If the moneys not there nobody gets paid.*' He views one of the reasons for builders failing is that there is no money in the production chain as banks are not lending to developers. He notes that guarantee accounts are already provided for in Clause 35 of the RIAI Contract but that this clause '*is invariably struck out by clients. If there could be a similar clause in the Construction Contracts Bill [which would be replenished by the employer as certificates were presented] it would achieve what Senator Quinn hoped to achieve by way of ensuring the money is there.*' He admits however that clients '*are not delighted*' with such arrangements.

Section 2 Construction Contracts: Exceptions etc

The RIA notes that the Bill does not apply to contracts below certain value thresholds, nor to private residential projects except for so called 'trophy homes'. The Assessment reports that including small commercial and domestic residential projects within the scope of the legislation was considered to impose a disproportionate burden on the contracting parties. It contends that a proportionate and fair regulatory response is required in response to the concerns of the various stakeholders and that '*on balance it would appear that the thresholds should be reviewed.*' (DPER, 2011)

Industry reaction to the proposed thresholds and scope restrictions has largely been negative. The Bill, as currently drafted covers non domestic construction contracts over €50,000 and €200,000 in the public and private sectors respectively. However the bulk, if not all, of the work on these contracts is carried out by sub-contractors with the main contractor typically performing a management role. The Bill contains

obvious gaps in dealing with this situation as the current thresholds effectively exclude not only the majority of repair, maintenance and improvement projects, but also subcontracts and material and equipment supply contracts. The CIF contended that *‘the legislation will not apply to the majority of sub-contractors, the group of people who are in greatest need of protections offered by this legislation’* (CIF, 2011) A CIF spokesman is quoted in McCaul (2011) as saying that the Bill should *‘apply to all construction contracts. If smaller contracts are excluded what you have done is bring in a solution for the larger contractors, a solution which is cheap and swift while at the smaller [contracting] end of the market you force them into more expensive arbitration.’*

The SCSi (2011) view the thresholds as *‘inappropriately blunt.’* and that unless *‘the [€200,000 private sector] threshold is not removed entirely that the legislation will have been a complete waste of time.’* They also recommend that the distinction between public sector and private sector projects should be omitted, claiming that such a distinction

“is likely to cause difficulties in that many sub-contracts will be private contracts and yet the main contract will be state funded and for various tiers of a project to be included or not included will inevitably give rise to confusion, dispute or unfairness in the process. It is imperative that this Act is unambiguous and clear and that it applies to all tiers of a project.”

A Prominent Chartered QS viewed the value thresholds in the Bill as a serious issue. *‘It doesn’t apply to projects less than €200,000. It is designed to protect the sub-contract industry, the next layer down from the RIAI contracts and it doesn’t do so. It will have no benefit to sub-contractors and sub-contractors cash flow if that is to remain.’* A Principal of an Architectural Practice believes that it would be beneficial to incorporate the residential market under the legislation. *“I think that the residential market is where a lot of the problems arise. I think you need the legislative equivalent of the small claims court.”* (both quoted in McCaul, 2011)

It may also be suggested that public sector projects over €50,000 and private sector ‘commercial’ contracts over €200,000 would normally be in writing and the current Bill provisions would only apply in isolated cases.

Within Leinster House there was widespread agreement that the thresholds must be reviewed with over twenty five deputies commenting on this matter during the debates. Deputy Mick Wallace, for example, described the current €200,000 threshold

as a *'joke and will completely nullify the good the Bill might do'* He added *"Those sub-contractors carrying out work on contracts valued at more than this amount have a far better chance of receiving payment than their smaller counterparts . . . [who] are in an extremely vulnerable position and require the protection provided by the legislation."* He called for contracts above €10,000 to be covered by the Bill. Minister of State Hayes in his closing remarks has indicated his intention *"to bring forward amendments to broaden its scope by reducing or removing altogether the current monetary thresholds in the Bill"* and to extend the *"legislation to include bespoke construction supply contracts"*. (Oireachtas 2012a, 2012d)

Section 3 Payment Provisions

Payments

The primary purpose of the Bill is to free up cash-flow within the Industry by ensuring timely payment, improving communication regarding deductions from payment claims and providing mechanisms to enforce entitlements.

The contract must identify or include an *'adequate mechanism'* to establish the payment claim dates **and** each interim and final payment amount. The contract must also stipulate the maximum period for making payments otherwise the Schedule provisions of 30 day intervals will apply unless the particular subcontract contains more favourable credit terms for the subcontractor. On contracts not exceeding 45 days, the payment claim date is to be 14 days following completion of the work and payment become due 30 days later.

Pay when paid clauses

Section 3.5 of the Bill seeks to prohibit 'pay when paid' arrangements except in limited circumstances usually involving employer insolvency. Minister of State Hayes views this as *'a significant change'*. Deputy Willie Penrose described it as a *'breakthrough'* with Deputy Stephen Donnelly adding that it would address a *'serious power imbalance in the sector'*. Deputy Dara Calleary, however questioned how the provision would be enforced. *'We can make legislation, but enforcement and breaking what has been a culture for decades . . . will be a bigger job.'* (Oireachtas, 2012a and 2012b) Knowles (2002), commenting on the prohibition of pay when paid arrangements following the enactment of 1996 UK Construction Act, hinted that some

main contractors may have retained their pay when paid clauses leaving subcontractors to complain that their contract does not comply with the Act.

A CIF spokesman welcomes the prohibition of paid when paid clauses. He accepts that such arrangements are the *de facto* standard payment situation in Ireland and notes that such clauses are likely to be declared illegal as '*grossly unfair*' under the incoming EU Directive on late payment. (quoted in McCaul, 2011)

The SCSI (2012) however raises a cautionary note on 'pay when paid.' They claim that main contractors typically provide 20% to 25% of the project finance with the balance being funded by subcontractors and suppliers. Banning pay when paid clauses, would force contractors to pay subcontractors within 25 days of receiving a payment notice. This would normally be before they are themselves paid, thereby requiring increased credit facilities in the current difficult economic climate. Whilst they suggest that this might be laudable, they warn that it will introduce a barrier to entry into the Industry, or will limit smaller companies ability to compete with larger contractors.

Certification Issues

A particular characteristic of the construction payment process is that the payment cycle is typically dependent on certification by employer's representatives, architects and consultant engineers under the main contract. The SCSI (2012) claims that Clause 3.5 cuts across this process. The Society warns that eliminating independent certification could affect nominated subcontractors payments in particular, as amounts due to these subcontractors currently must be separately identified by the certifier in interim certificates. They advise that independent certification should be maintained as courts view this practice as a key element in effective contracts and that it provides certainty for the contracting parties involved. The Society claims that the removal of the ability of a main contractor to agree payment terms with a subcontractor would be a new concept for the Industry. They argue that this will allow main contractors to self certify the amounts to be paid to subcontractors. The Society warns that particular instances such as certifying whether subcontract work is complete could potentially cause 'endless disputes'.

Section Four Payment Claim Notices

This section sets out the detailed procedures for claiming payment. Minister of State Hayes, contends that in the event that a payment claim is disputed that the parties will now be clear about the basis for and the amount in dispute.

A CIF Spokesman (reported in McCaul, 2011) views this as one of the main benefits of the legislation noting that a proper account must first be submitted in order to avail of the remedies in the Bill. He added that *'parties to construction contracts [will] be more conscious of the terms of the agreement and be far more ordered in the way they claim money. . . Ad hoc practices [of haphazard claim submittals] will disappear; well they will diminish considerably.'*

McCaul, (2011) refers to the practice of payers using claims for loss or damage as an excuse for not paying, even for those elements of work over which there is no dispute. He reports the approach of a Principal of an Architectural Practice in dealing with such situations *"I think that main contractors shamefully make use of that approach all the time [the dispute over €10,000 of a €100,000 bill stopping payment being made].*

"I think the problem is, particularly in the last couple of years, that there is so little work going around that the sub-contractor does not want to fall foul of the main contractors. I think the increasing number of sub-contractors which are going to the wall is not because they are not trading properly but because of cash flow; not having the money passed onto them is a major problem. . . If I get wind that a sub-contractor is not getting paid, I will force the main contractor to pay him before I release another cert."

The SCSJ (2012) contend that a contractor should submit the payment claim notice on or before the payment date rather than within five days of the payment claim date to their employer. They claim that the five day time allowance potentially reduces the employer's response time to 16 instead of 21 days, which may impact negatively on the ability to carry out a full assessment of the claim within the allotted and may give rise to disputes.

Deputy Mary Lou McDonald noted that this Section does not provide for occasions where a payer does not respond to a payment claim. She suggests that the full claim should be paid in such instances and that this would encourage main contractors to respond to disputed payment claims. (Oireachtas, 2012a). There was little further comment on this particular section during the Dail debate.

Section 5 Actions regarding non-payment

Right to Suspend Work

Minister of State Hayes claims that the right of a subcontractor to suspend work if a contractor wrongly fails to pay in accordance with the Bill, will ‘*rebalance the power between the contracting parties, without unduly hampering the completion of the project.*’ This viewpoint, however, was disputed by a number of deputies during the debates. Deputy Mary Lou McDonald expressed the view of her party

“that the right to suspend work for non payment cannot be restricted to two weeks. This will not act as a sufficient deterrent under the law. If the Government was to persist with the two week suspension limit it would undermine the purpose of the provision. It would be unreasonable to ask subcontractors to go back to work after two weeks having still not been paid and to incur further costs.”

Deputy Sean Fleming referred to subcontractors crawling back on day 15: ‘*That is no good and that subcontractor is probably in a worse position crawling back onto the site to resume the work. That must be re-examined*’ he said. Deputy Mick Wallace, taking a main contractor’s perspective, warned that the current provisions presented dangers:

“on occasion a main contractor could be getting a raw deal from the subcontractor. For example, such a subcontractor might not do the work right and could then state he was not going to do any further work until he was paid. If there is going to be a period during which the adjudication panel will try to ascertain where the truth lies and who owes what to whom, it would not be fair to bring work to a halt during that period.”

Minister of State Hayes has agreed that ‘*the two week time limit preventing contractors from withdrawing services in the event of non-payment where work has been carried out to a satisfactory standard seems insufficient and, therefore will need to be amended.*’ (Oireachtas, 2012a, 2012c and 2012d)

Industry opinion is also critical of the provisions. The SCSI (2012) notes that the Bill removes a widely used contractual remedy, which provides contractors with the option to determine their own employment in the event that payment is not made by the end of the period of suspension. They claim that affected contractors and subcontractors will be obliged to resume the works after the 14 days of suspension without payment, while remaining exposed to the risk of termination if they fail to return to work. The Society contends that the right of the affected subcontractor to

terminate should be preserved or enshrined in the legislation. The Society also argues that reasonable delay, remobilisation and rectification costs caused by the suspension of work should be reimbursed and likewise additional time should be allowed.

A Prominent Chartered QS views this aspect of the proposed legislation as a ‘*dangerous issue.*’ He claims:

“You can suspend in the RIAI for non payment. You can terminate for non payment, if you do not have a contract you would not have the ability to suspend, and what this does, is it brings this ability to suspend. So for people who have no contracts at all you can suspend. However, you can only suspend for fourteen days. In such circumstances you cannot terminate you must return to work. It does then provide a benefit for someone who would not habitually sign a contract, albeit a temporary benefit, it actually cuts across the traditional RIAI form and worsens matters for all those people who sign contracts.” (quoted in McCaul, 2011)

A CIF Spokesman claims that “*In Ireland it is hard to stop working once a contract is started. . . . The idea that you can only suspend work for fourteen days, under the proposed legislation, and then have to return to work is not workable. It will likely be amended.*” (quoted in McCaul, 2011)

Adjudication Provisions

A detailed analysis of the Adjudication provisions is beyond the scope of this study. Nevertheless it is a key component of the Bill and is the means by which ‘payment disputes’ may be resolved. As currently drafted, the Bill holds that an adjudicator’s decision is binding unless referred to arbitration or litigation. This has identified as a particular weakness in the Bill. Deputy Olivia Mitchell remarked that ‘*The real danger is that the new adjudication process would be used as another time waster before one got to conciliation and so on, postponing court appearances for as long as possible.*’ Deputy Mary Lou McDonald added that this approach ‘*often suits large contractors with significant resources behind them to drag out challenges to non payment through existing processes or through the courts.*’ Minister of State Hayes has indicated that that the best option is to make adjudicators awards binding but this is “*complex. We have to get the balance right between giving this legislation the necessary enforcement provisions and ensuring its application is equitable and the taxpayer is safeguarded*” (Oireachtas, 2012a, 2012d)

Industry reaction has also been critical of the perceived weakness of the adjudication proposals. A CIF Spokesman believes that the idea that the adjudication is not binding

in the interim “*is just lunacy*” adding that “*Either party can refer the dispute on to arbitration or litigation and the other party need not pay until the matter is resolved. . . . The big concept in the Bill is that you could resolve the dispute and get paid, at least in the interim.*” He claims that this element of the Bill is seen as the single most important factor in freeing up cash flow in the UK. A Prominent Chartered QS agrees adding that “*the inability to enforce the adjudication award in the face of arbitration referral is a major disaster. You can’t progress the award.*” (both quoted in McCaul, 2011)

The second stage readings of the Bill revealed that there was near unanimous support for its implementation. Nevertheless it was clear that there were several weaknesses in the proposals which need to be addressed. Minister of State Hayes’ closing remarks included a commitment to introduce various amendments at Committee stage to improve the operation of the Bill. These include reviewing the current value threshold and suspension of work provisions, broadening the range of suppliers covered, and introducing robust adjudication provisions.

Industry representatives interviewed by McCaul (2011) believe, that provided the necessary amendments are incorporated, the Bill will be beneficial. A CIF Spokesman believes that “*The Construction Contracts Bill, depending on its terms when it is enacted will certainly make a difference.*” A Prominent Chartered QS believes that the Bill will help improve cash flow “*in principle, yes, based on the assumption that the current Bill is changed. It won’t in its current form unless it is changed.*” It may also be suggested that the cool reception for the Bill by the Construction Professions and industry representative bodies may be significantly warmer following the Committee Stage deliberations.

International initiatives

The problem of late payment is not confined to Ireland and this issue has been addressed by various legislative initiatives abroad. Of particular relevance is the UK Housing Grants, Construction and Regeneration Act 1996 (The UK Act) which was prompted by the recommendations of the Latham Report (1994). Comparable legislation has also been introduced in New Zealand 2002, Singapore 2004, Isle of Man 2004 and various Australian States between 1999 and 2004. The UK legislation

has been updated in 2010 following a review of the legislation by the UK Office of Government Commerce.

The 1996 UK Construction Act implemented the following provisions on *all* construction projects:

- pay when paid clauses are unenforceable;
- payment by instalment for all contracts over 45 days duration;
- the contractor is to be informed when payment is due as well as the amount;
- the contractor is to be informed if the client is to withhold payment;
- the contractor has the right to withdraw from the site if not paid within a specified period. (Cartlidge, 2013)

These requirements closely echo the provisions of the Irish Bill. The question is - has the UK legislation been effective in improving payment practice?

In his budget statement of March 2004, the Chancellor of the Exchequer stated that:

“Following concerns expressed by the construction industry on unreasonable delays in payment, the government will review the operation of the adjudication and payment provisions [of the Act] . . . to identify what improvement can be made”.

The review was carried out under the chairmanship of Sir Michael Latham and the report which was published on 17th September 2004 concluded that while the Act was generally working well, particularly with regard to adjudication, that ‘*poor payment practices continue to be a major issue*’. (DTI 2007)

The Payment Practice Group considered ten specific issues which were identified as causing difficulties in achieving the Act’s objectives. Of particular relevance was the observation that a loophole of using ‘pay when certified’ clauses was widespread practice and this has the same effect as ‘pay when paid’ clauses. The group also expressed concern over the length of the payment periods and identified that ‘*some agreements appear to have made this intervening period as long as 180 days*.’ The group observed that this problem is often due to payment abuse rather than contractual agreement. The group admitted that it could ‘*identify no effective measure to prevent any lengthening in contractual payment periods*.’ (Latham, 2004)

Sir Michael in his covering letter to the then Construction Minister, Nigel Griffiths MP presented his views on the progress achieved by the Act. It was obvious that progress was somewhat disappointing.

So one must be looking all the time to ensuring that the correct amount of money is paid on time. The correct amount may not be what is offered or what is demanded. It must properly reflect the satisfactory work which has actually been done in accordance with the contract. Moreover “on time” should reflect the contractual agreement between the parties. “Late payment” is not an abstract concept. It should be assessed against a time which has been mutually agreed in the contract, rather than some vague notion of what a desirable timescale is. If the parties have agreed to a 90 days payment cycle, a 90 day payment is not “late”. But if they have signed a contract for a shorter period, and the payment is not made until 90 days that is late and the aggrieved party already has statutory rights of adjudication and/or suspension. Nobody has a right simply to be paid what they demand, because that may not be the correct amount. But equally, they do have a right to be paid that correct amount on time, irrespective of whether other parties in the supply chain have themselves been paid. That is not transference of risk or altering the balance. It is quite simply, reinforcing and honouring the contractual agreement between the parties. . . .the general principle of proper payment on time must hold good. (His emphasis)

He continued later

Where there is an adversarial relationship from the start of the process . . . there are likely to be irreconcilable commercial approaches to payment by the demand and supply sides. The Construction Act has not yet achieved a balance outcome between them all, though it has certainly dealt with some of the least desirable practices.

In 2005 Odeyinka and Akintoye carried out a survey of contractors’ satisfaction with payment terms influencing construction cashflow. The survey received 100 responses, 30 of which were from subcontractors. They found that while main contractors were generally satisfied with contractual payment terms, they were dissatisfied about payment time lags and the percentage of the contract sum retained. The subcontractors surveyed were dissatisfied with payment methods, payment time lags and highly dissatisfied about amounts retained. Their study called for ‘*innovative payment systems to be devised that will not put the subcontractor at a disadvantage by putting him at the end of a long payment chain.*’

Following Latham’s 2004 Report an industry-wide consultation and analysis process ensued and *Improving Payment Practices in the Construction Industry: 2nd Consultation on Proposals to Amend Part II of the Housing Grants Construction and Regeneration Act 1996 and the Scheme for Construction Contracts (England and*

Wales) Regulations 1998, was published in 2007 which proposed a number of modifications and improvements to the 1996 Act. The 1996 Act was superseded by the *Local Democracy, Economic Development and Construction Act 2009*. (Royal Institution of Chartered Surveyors 2013) Many of the provisions and modifications of the UK 2009 Act have been incorporated in the Irish Bill or have been submitted by the professional bodies as part of the second stage process.

Further afield, Ramachandra and Rotimi (2012) reporting on the performance of New Zealand legislation found that *'payment delays are still prevalent within the industry'* ten years after the introduction of New Zealand Construction Contracts Act. They report that main contractors experienced delays in being paid on between 10-40% of contracts while subcontractors fared much worse, experiencing delays in the range of 10% to 80% of contracts. Consultants and contractors judged the legislation to moderately and slightly effective respectively.

In New South Wales, Brand and Uher (2010) found that the object of the New South Wales Act is *'generally being achieved.'* They concluded that *'the culture of making late payments remains well entrenched in the construction industry'*. Their follow-up survey of 317 contractors and subcontractors revealed *'a modest downward trend in the frequency of late payments'*. They found that *'78% of firms generally experience late payment to varying degrees of severity, with almost half indicating that they receive late payment 'often' or 'always'*. They also found that many contractors and sub-contractors have limited knowledge of the Act and are under-utilising the very legislation designed for their benefit.

There are difficulties in making direct comparisons with the UK and international experience. Various factors such as market size and other 'unknown' factors such as levels of compliance and size of the hidden economy may render such benchmarking somewhat unreliable. (DPER, 2012) Nevertheless international experience, provides valuable insight and feedback which may help to predict what might occur should comparable legislation be enacted in Ireland.

Conclusion.

The question remains will the proposed legislation be effective change the ingrained culture of delayed and inadequate payment within the industry. The current ISME credit watch survey would suggest that the world is full of people who do not pay

their bills on time. This review has shown that cash-flow is essential to operating a healthy contracting organisation. Despite the fact that main contractors are typically paid in arrears they can run positive cash-flow projects by adopting effective reimbursement strategies for early and full recovery from clients whilst delaying and reducing outgoings to suppliers and subcontractors. The market in the construction industry is far from perfect and subcontractors suffer from a lack of security of employment and typically depend on a small number of larger contractors for business. This brings about a power imbalance which the Bill seeks to address. This review has argued that the Bill is welcome but needs to be modified to address industry concerns and practical operational issues. Overseas experience has shown that while similar legislative initiatives have delivered benefits, a more critical eye might view the results as disappointing.

People are slow to part with their money and reluctant payers are ever inventive in circumventing or ignoring legislation. Nevertheless change is usually a gradual process and rarely comes about overnight. The enacting of the Bill will probably be, to use the words of a number of deputies, ‘a step in the right direction’. This writer’s opening statement, like the Bill, may now need to be modified. It is one thing to change the law; changing the culture is another thing entirely.

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