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Insight

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Don't forget to have your say: Government Consultations on Retention and the Housing Grants Act close on 19 January 2018[1]

The Government is currently running two parallel consultations aimed at encouraging best practice in fair and prompt payment within the construction sector. These are as follows:

1. A consultation to support a post-implementation review of the 2011 changes to Part 2 of the Housing Grants, Construction and Regeneration Act 1996 (the "Housing Grants Act" and the "Housing Grants Consultation"); and

2. A consultation on the practice of cash retention under construction contracts (the "Retention Consultation").

Both consultations close on 19 January 2018 and, as such, only a couple of weeks remain to contribute. In this Insight we consider some of the key aspects of the Consultation Papers.

The Housing Grants Act – a post-implementation review

At the time the amended Housing Grants Act came into effect in October 2011, the Government promised that it would undertake a review five years later in order to determine how effective the amendments (and the Housing Grants Act as a whole) were. The Housing Grants Consultation, accordingly, states that its primary aim is to test the effectiveness of the amendments made in 2011.

For those who need a refresher these were:

"...

- *remove the restriction on who could issue a payment notice;*
- *improve the clarity of payment and withholding notices;*
- *introduce a 'fall back' provision – allowing a payee to submit a valid payment notice where a payer has failed to issue one;*
- *prohibit payment by reference to other contracts;*
- *introduce a statutory framework for the costs of adjudication;*
- *remove the requirement for contracts to be in writing for the Act to apply; and*
- *improve the right of suspension."*

There are two key interests flowing through the consultation. These are:

1. Encouraging prompt and fair payment particularly for small companies;[2] and
2. The costs associated with the adjudication process and the extent to which they are a disincentive for using it.

We examine these below.

"Smash and Grabs" and Payment Procedures

If parties implement the provisions of the Housing Grants Act properly, and keep up with their paperwork, then the payment mechanisms as amended should be relatively effective in encouraging prompt payment. At the very least they should encourage transparency as to what is going to be paid and when.

Disputes generally arise in relation to the notice provisions under the Housing Grants Act when a party fails to follow the notice provisions relating to payments (e.g. by failing to issue Payment Notices on time) and/or tries to be "sneaky" in some way (e.g. by not clearly identifying what they are serving or putting it in a slightly different format to normal).[3]

It is to be hoped that now the notice procedures for payment cycles have bedded in, and familiarity with them has increased, parties are adopting more robust procedures to ensure the relevant notices get issued on time. There is certainly anecdotal evidence that this is the case. Similarly, parties do now have a better idea of when they can, and cannot, "*smash and grab*" or enforce their entitlements for that particular payment cycle in light of the guidance issued by the courts over the past few years.

Despite the extensive case law that followed the introduction of amended payment provisions, it is hard to see how amending them again is likely to do anything other than create uncertainty and more case law in the short term. This is particularly the case where there seems to be a decline in the number of unjustified "*smash and grabs*", with parties starting to adopt a more sensible approach than seen in some of the cases going through the courts a few years ago.

It remains to be seen, however, whether the consultation results in any ideas for simplifying the notice procedures in a way which is not likely to spark a new range of case law on those procedures should be interpreted.

The Costs of Adjudication

Adjudication sometimes can, unfortunately, be expensive and/or its costs disproportionate especially if the value of the dispute is not that high but the issues are not straightforward. This can be made worse if one party's position is unclear or badly formulated and/or the adjudicator's charge-out rate is higher than would be ideal for the value of the dispute. *Game playing* can also result in higher costs than are necessary, although often what could be labelled "*game playing*" by one party is a jurisdictional challenge that the other party believes is a necessary and fair check on a process that would otherwise plough ahead regardless.

However, adjudication can equally be a very quick and cost-effective method of dispute resolution when used properly by the parties and, just

as importantly, where the adjudicator controls the process.

The Housing Grants Consultation is aimed at looking at whether the costs of adjudication are now so high that they are impacting on its use. Some obviously think they are. The article "Is Adjudication too expensive?",[4] for example, in the recent *Adjudication Society Newsletter* suggests that too often adjudication is too expensive for small businesses to undertake. Likewise the recent research carried out by Janey Mulligan and Amy Jackson of Construction Dispute Resolution indicates that hourly rates for adjudicators have increased (the average fee being £210 and the top rate recorded being £330) as well as the average fee charged (up by £4,000 since 2011). That said, they also note that higher rates did not always result in higher overall fees, suggesting a more expensive or experienced adjudicator may understand the issues more quickly and/or run the process more efficiently.[5]

It will be interesting, therefore, to see what suggestions come out of the consultation in relation to adjudication costs. One thing that would undoubtedly put parties off adjudication, in the author's view, is if one party has to pay the other side's costs as well as their own. It is, by all accounts, extremely rare for a party to agree to pay the other side's costs after an adjudication has commenced.[6]

To this end it would be helpful to have certainty as to whether the Late Payment of Commercial Debts (Interest) Act 1998 applies to adjudication or not, given that there is now contradictory case law on the topic.[7] In the author's view it does not apply, and should not apply, given the express provisions on costs seen in section 108A of the Housing Grants Act. It should also not be forgotten that for complex and high value disputes it may be better to avoid the temptation of adjudicating and progress straight to TCC proceedings if applicable. Recovering costs is not then going to be an issue (provided you succeed in bringing your claim).

Finally, it remains to be seen whether the consultation results in any proposals for simplifying the adjudication process which will not, at the same time, result in it losing some of its necessary checks and balances.

The Retention Consultation

The Retention Consultation, and its use within the construction sector, was published in parallel with a research paper on retentions in the construction industry generally which was produced by Pye Tait Consulting on behalf of the Department for Business, Energy & Industrial Strategy (the "BEIS Research Paper").[8]

Previous amendments to the Housing Grants Act sought to prevent delays to the release of retention monies by reference to performance obligations under another contract.[9] Under the previous Act, the release of retention monies further down the contractual chain was frequently made conditional upon the main contractor receiving a certificate of making good defects. This could have serious implications on the cash flow of those further down the contractual chain.

The BEIS Research Paper noted that, despite this reform, there were still substantial delays to the release of retention monies. It noted that:

> *"Delays in paying retention monies appear to be commonplace in the construction sector. Around 71% of contractors surveyed with experience of having retentions held in the last three years have experienced delays in receiving retention monies over the same period."*[10]

The paper also notes that the higher up the contractor is in the contractual chain the less likely they are to suffer from non-payment of retention monies.[11] It notes further that it is the "*unjustified late and non-payment of retentions*" that "*appears to be a significant cause of the issues associated with the practice of holding retentions within the construction sector*"[12].

Another major issue preventing the repayment of retentions is noted as being insolvency higher up the contractual chain. As retention monies are held in the main bank account of the entity holding them (i.e. the monies are not in any way "ring-fenced") they fall into the general insolvency pot of monies and are then distributed to creditors in accordance with the applicable insolvency rules and regulations.

The BEIS Research Paper notes that:

> "**A significant proportion (44%) of contractors** *surveyed with experience of having retentions held from them in the last three years* **have experienced non-payment of retention monies as a result of upstream insolvencies** *over this same period ..."*
> [Emphasis added]

The impact of the late retentions is noted as being: (1) higher business overheads pursuing outstanding monies; (2) weakened relationships within the contractual chains due to strains being placed on relationships; (3) weakened relationships with clients for main contractors; (4) increased costs for projects as tender prices are increased to cater for the risks associated with retention monies; and (5) impeded business growth.[13]

The BEIS Research Paper also looks at possible options for increasing protection for retention monies including: Project Bank Accounts, Retention Bonds, Performance Bonds, Escrow Stakeholder accounts, parent company guarantees and retention held in trust funds. In doing so it also examined schemes in other countries such as New South Wales, Australia (where retention money held on projects worth over A$20m must be held in a trust account with an authorised deposit-taking institution)[14] and Canada (where retention monies must be held in a separate account).

The BEIS Research Paper itself concludes that there are only two potential options that could be real alternatives to cash retentions: (1) a retention deposit scheme of some sort with the monies held on trust; or (2) retention bonds. However, it notes the cost of retention bonds in particular could be problematic and that their "on demand" nature would also cause issues. The other suggestion of the Retention Deposit Scheme is examined in the BEIS Research Paper although it is not entirely clear what would trigger the release of the money

(unlike the Rent Deposit Scheme which is released at the end of tenancy).[15] As such it recommends that further research be carried out into alternative mechanisms for retention and, in particular, "*a retention deposit scheme and holding retentions in a trust account*".[16]

Given recent headlines on retentions being lost due to insolvency (the headline in *Construction News* on 5 January 2018 – "Outrage as McMullen revealed to owe £646k in retentions" – is one such example), it is clear that coming up with a viable scheme for protecting retentions, which is not overly burdensome or costly to run, would benefit the industry as a whole.

As such it can only be a good time for the Retention Consultation which aims to explore further:

"...

- *the effectiveness of existing prompt and fair payment measures for retentions;*
- *views on the independent research on retentions in the construction industry and the BEIS Consultation Stage Impact Assessment;*
- *late and non-payment of retentions;*
- *the appropriateness of a 'cap' on the proportion of contract value that can be held in retention, and the length of time it can be held;*
- *the effectiveness of existing alternative mechanisms to retentions; and*
- *the costs and benefits of a 'retention deposit scheme '."*

Don't forget to have your say!

Finally, it is still not too late to have your say on these consultations by following the links below:

https://www.gov.uk/government/consultations/2011-changes-to-part-2-of-the-housing-grants-construction-and-regeneration-act-1996

https://www.gov.uk/government/consultations/retention-payments-in-the-construction-industry

Footnotes

1. By Claire King with assistance from Laura Bowler.
2. See the Ministerial Foreword by Lord Prior of Brampton on page 3 of the Consultation.
3. For example, see *Caledonian Modular Ltd v Mar City Developments Ltd* [2015] EWHC 1855 (TCC) or *Henia Investments Inc v Beck Interiors Ltd* [2015] EWHC 2433 (TCC).
4. By the anonymous "J.R. Hartley".
5. See "The Costs of Adjudication – What to Expect when You're Expecting" in the *Adjudication Society Newsletter*, Winter 2017, as well as the more detailed paper "Adjudicators' Fees" by J Milligan and A Jackson, November 2017.
6. See section 108A of the Housing Grants Act which only allows parties to agree to allocate costs if the agreement is in writing and made after the notice of intention to refer to adjudication is issued.
7. See *Lulu Construction Ltd v Mulalley & Co Ltd* [2016] EWHC 1852 (TCC) and also *Enviroflow Management Ltd v Redhill Works (Nottingham) Ltd* (unreported).
8. See the BEIS Research Paper.
9. "Retention Payments in the Construction Industry — A consultation on the practice of cash retention under construction contracts", 24 October 2017, page 12 by BEIS.
10. See the BEIS Research Paper, page 20.
11. Ibid.
12. Ibid., page 21.
13. Ibid., pages 22—23.
14. See the Building and Construction Industry Security of Payment Regulation 2008.
15. BEIS Research Paper, "Retention in the Construction Industry", October 2017, page 130.
16. BEIS Research Paper, page 26.

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