

# EVALUATING THE EFFECTIVENESS OF CONSTRUCTION PAYMENT PROVISIONS IN NEW ZEALAND

Thanuja Ramachandra<sup>1</sup> and James Olabode Bamidele Rotimi<sup>2</sup>

<sup>1</sup> *School of Engineering, Auckland University of Technology, Auckland, New Zealand*

<sup>2</sup> *School of Engineering, Auckland University of Technology, Auckland, New Zealand*

## ABSTRACT

Standard forms of contract and Construction Contracts Act (CCA) are designed as primary means of mitigating payment problems within the New Zealand construction industry. However, payment problems have been on the increase since last four decades. The research therefore evaluated the effectiveness of those payment provisions. Construction practitioners surveyed were of the opinion that overall the provisions in the standard forms of contract and the CCA are moderately effective. The right to claim and right to respond to claims under both documents are more effective than the provisions for non-payments. Detail analyses of views indicate that 20-30% of participants found the provisions highly effective while another equal percentage considered them slightly effective. This distribution of effectiveness is supported by the views which include: the CCA improves payment problems as it resolves disputes faster; the CCA is incapable of guaranteeing payment; failure to comply with the CCA provisions and reluctance to apply the provisions on certain reputed project partners. The research therefore recommends that there needs to be changes to the CCA to have a separate mean(s) of securing payment in the form of escrow account, payment bond or any other means. This would encourage construction parties to use the CCA provisions and thereby improve the effectiveness of the overall Act.

Keywords: Construction Contracts Act, standard forms of contract, Effectiveness, New Zealand, Payment provisions.

## INTRODUCTION

Payment is the core of any economic transaction without which any entity cannot succeed in business. This is more vital in the construction industry due to the construction process taking relatively longer time, the expensive nature of the product, and payment being made upon the completion of the product (Ameer-Ali 2006). In reality any party who supplies goods and services in the construction industry is exposed to the potential risk of late payment, under payment, and non-payment for several reasons (Hughes, et al. 1998). Therefore the payment problem have caused significant concerns in the construction industry.

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<sup>1</sup> tramacha@aut.ac.nz

<sup>2</sup> jrotimi@aut.ac.nz

Standard forms of contract offer provisions covering payments and non-payments. These provisions stipulate the procedure and time frame for claiming payments, responding to payment claims and taking remedial measures in case of non-payment. The provisions enable parties to deal with payments efficiently. However in reality parties fail to adhere to the stipulated time frames in payment procedures, often due to deliberate delays of payment for their own benefit, inefficiencies in the internal system of the companies, and the usual business practice of delaying payment etc. Euginie (2006) and Sin (2006) are of the view that standard forms of contract for main contracts often fail to stipulate payment provisions for domestic subcontractors and suppliers. This leaves them with no protection against the risk of financial inappropriateness of their upper tiers.

From a legislative point of view, there is reason to suggest that the widespread nature of payment problems caused the development of construction payment specific legislation in different jurisdictions. For example, the Construction Contracts Act (CCA) 2002 was promulgated in New Zealand following the failure of many large construction companies due mainly to non-payments by project owners/developers (Bayley and Kennedy-Grant 2003; Degerholm 2003). The collapse of large construction companies left a large number of subcontractors and suppliers unpaid. Notwithstanding that the CCA is in place, there have been observed instances where the Act was incapable of remedying payment delays and losses experienced by contractors and subcontractors due to insolvencies of developers and construction companies. For example, a developer was liquidated following a tax claim of \$7million and the liquidator of the company indicated that there were insufficient funds available to distribute among unsecured creditors but the preferential creditor, Inland revenue department (IRD) will be settled with company's assets (Gibson 2008).

This research therefore evaluates the effectiveness of payment provisions available within the mostly used standard forms of contract and the CCA 2002 in the New Zealand context. This study is the primary step towards mitigating payment problems within the New Zealand construction industry.

## **RESEARCH APPROACH**

To investigate the effectiveness of payment provisions available within the standard forms of contract and the CCA, the research adopted a survey approach using an online questionnaire. The online survey was administered to professionals operating under three major industry groups, consultants, head contractors and subcontractors within the New Zealand construction industry. Participants were required to indicate the effectiveness of the provisions within both regulatory documents on a scale of 1 = Not at all Effective to 5 = Extremely Effective. By effectiveness of the provisions the study considered the extent to which individual provisions fulfil the purposes for which they were designed. For example: to what extent the adjudication provision within the CCA helped respondents to resolve disputes and recover their money due under the contract? The use of Likert scale enables the assessment of the degree of effectiveness of the provisions was perceived by the participants.

A total of 989 participants were approached through their trade associations such as: New Zealand Institute of Architects (NZIA), New Zealand Institute of Quantity Surveyors (NZIQS), New Zealand Contractors Federation (NZCF) and Project Management Institute New Zealand (PMINZ). 112 (11% of total participants whom the online survey link was distributed to) participants responded to the survey. Table 1

presents the profile of the research participants. As observed from the table, the sample consists of rationally distributed views amongst main industry groups and participants' professions. In terms of their experience, more than 80% of participants had above 15 years of experience in the industry. The profile information gives validity to the research findings, despite the lower response rate of the survey.

Table 1: Profile of research participants

Profile Information		Number of responses	%
Major Industry Group	Subcontractor	40	36
	Head contractor	14	13
	Consultants	58	52
Profession	Project Manager	18	16
	Engineer	13	12
	Architect	27	24
	Quantity Surveyor	28	25
	Others	26	23
No. of Years of Experience	0-5 years	2	2
	6-10 years	9	8
	11-15 years	9	8
	16-20 years	13	12
	21-25 years	19	17
	More than 25years	60	54

## RESEARCH FINDINGS

In evaluating the effectiveness of payment provisions, participants were asked to respond to two structured questions which include: the extent of effectiveness of individual provisions within the CCA and the mostly used standard forms of contract. Beside the above structured questions, participants were given the opportunity to express their views about the CCA in general. The following sub-sections discuss the participants' views in relation to the three questions.

### Effectiveness of provisions within the CCA

Table 2 arranges the provisions according to their mean values and standard deviations calculated using the number of responses collected respectively. As observed from the mean values for individual provisions, the respondents indicated that all the provisions are 'moderately effective'. Further according to mean values and standard deviations, payment provisions 'P1' (mean = 3.21; standard deviation = 1.08) and 'P2' (mean = 3.20; standard deviation = 1.11) seem to be the most effective payment provisions within the CCA.

Table 2: Payment and non-payment provisions within the CCA

Provisions	N	Mean	Std. Deviation
Right to respond to claim: payment schedule (P1)	116	3.207	1.075

Right to claim payment (P2)	117	3.205	1.110
Right to suspend the work (NP1)	114	2.851	1.228
Right to refer to adjudication (NP2)	111	2.820	1.208
Right to review and enforcement of adjudication determination (NP3)	109	2.771	1.190
Right to apply for a charging order ( NP4)	108	2.722	1.199

Detailed analysis of the frequency of each provision is depicted in Figure 1. As observed, the majority of participants (about 30%) were of the opinion that all provisions are moderately effective. Another 20-30% stated that all provisions are highly effective. Considering non-payment provisions, the results show that around 10% were of the opinion that the provisions are extremely effective. According to about 14% of the participants, the right to payment claim (and payment schedule) is an extremely effective provision of the CCA. On the other hand, only a small percentage of (6%) respondents indicated that both provisions ‘P1’ and ‘P2’ are not at all effective. Another 20% described the two provisions as slightly effective.

Around 17% reported that the CCA provisions on the right to suspend work (NP1), apply for charging order (NP4), refer to adjudication (NP2), right to review and enforcement of adjudication determination (NP3) are not at all effective. However, for another 20-30% of participants those provisions seem to be slightly effective.

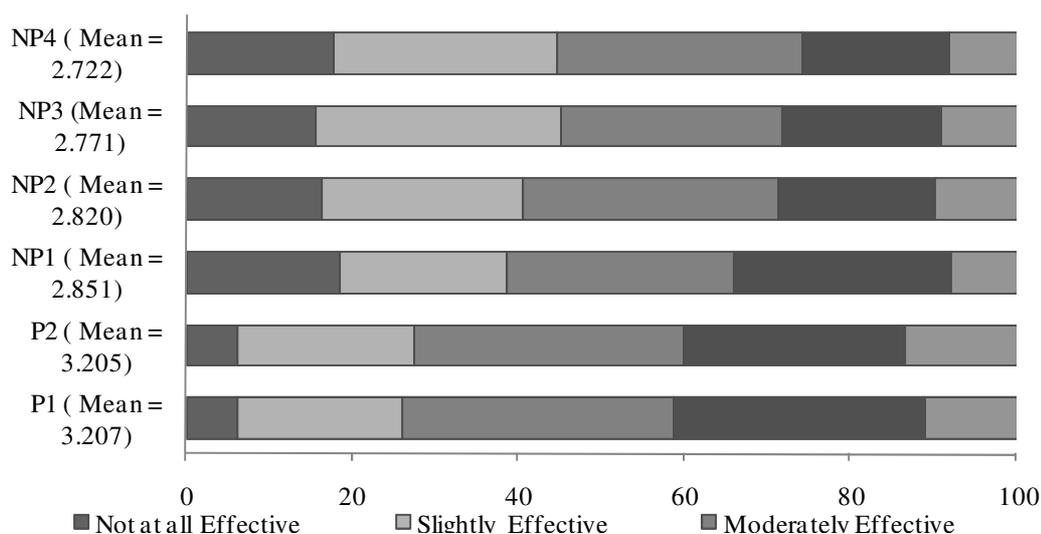


Figure 1: Distribution of effectiveness of payment provisions within the CCA

### Effectiveness of provisions in the standard forms of contract

Table 3 presents participants views on the effectiveness of provisions within the standard forms of contract. Four provisions: P1, P2, NP1, and NP2 with their respective mean and standard deviations are presented. It is apparent from the table that the provisions within the standard forms of contract are moderately effective. From the mean values calculated, the right to claim (P2) and the right to respond to claims (P1) seem more effective than the two non-payment provisions (NP1 and NP2).

Table 3: Payment provisions in the standard forms of contract

Provisions	N	Mean	Std. Deviation
Right to respond to claim: payment schedule (P1)	114	3.168	1.104
Right to claim payment (P2)	116	3.138	1.094
Dispute resolution methods: Arbitration, mediation and negotiation (NP1)	109	2.945	1.192
Right in case of non-payment: Suspension and termination (NP2)	108	2.694	1.226

The responses are further illustrated in Figure 2 with the distribution of responses on the effectiveness of the provisions within the standard forms of contract. A large percentage (30% and above) of respondents were of the opinion that the provisions are moderately effective. Another 25% and above indicated that those provisions are very effective. For another 10% of respondents the provisions seem extremely effective. On the other hand, a small percentage (7%) reported that the contractual rights to claim payment (P2) and respond to claims (P1) are not at all effective. Another 22% stated that both 'P1' and 'P2' are slightly effective. Considering non-payment provisions, around 30% of respondents were of the opinion that both NP1 and NP2 are slightly effective. The provisions, NP1 and NP2 are not at all effective according to 12% and 19% of respondents respectively.

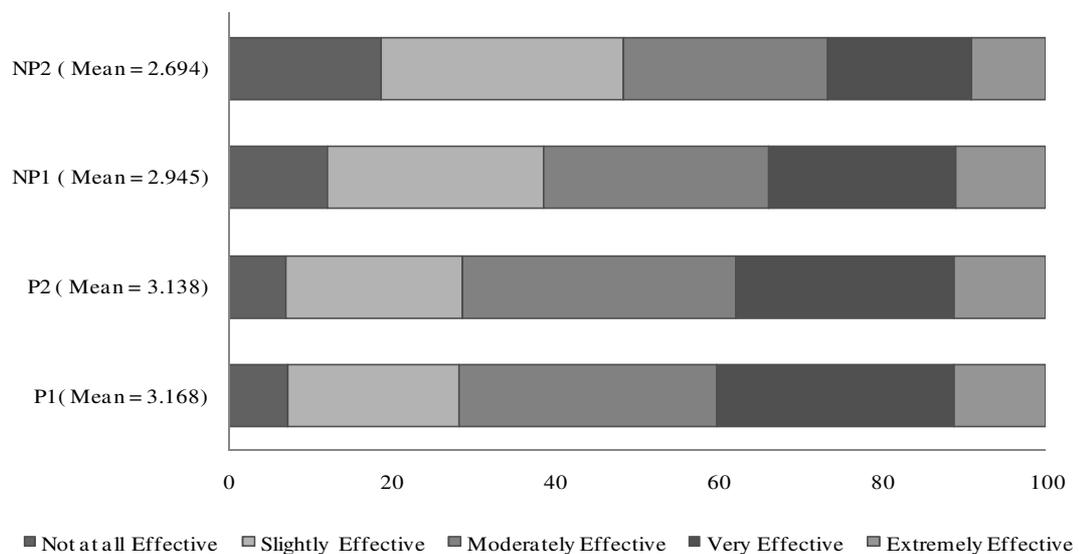


Figure 2: Distribution of the effectiveness of payment provisions in the standard forms of contract

### Views of CCA in general

Participants were of the opinion that there are strengths and weaknesses within the CCA provisions. Two out of the eight participants that responded to the open-ended question indicated that the CCA is an effective piece of legislation which helps to resolve disputes and remind parties about their payment obligations. However, one of the participants indicated that although the CCA improves payment practices by

resolving disputes in a timely manner, a failure to comply with its requirements could negate its usefulness. Further, some of the participants were of the opinion that the CCA fails to address certain issues around payment. Variations and retention monies in particular are payments which cause problems in construction contracts. The CCA stipulates no specific rights regarding the management of variation claims and retention recovery. Another participant clarified that the CCA does not guarantee payment. The reluctance of some of the project participants to apply the CCA provisions against reputed clients and contractors was a concern and leads to the moderate effectiveness indicated by participants of the CCA. Thus participants are wary of using the CCA because of the impact it could have on their relationships with other parties in the industry.

## CONCLUSIONS

As a way of mitigating payment problems within the construction industry, this study examined the effectiveness of payment provisions within the CCA and standard forms of contract. Overall payment provisions within both the standard forms of contract and CCA are found to be moderately effective. Detail analysis of the views held by research participants shows that only a small percentage (20-30%) of participants are of the opinion that the provisions are highly effective. Moderate effectiveness is justified due to the two-side effects of the CCA. On one end participants fail to apply and adhere to the procedures stipulated to deal with payment issues. Lack of knowledge and understanding, and the reluctance of lower tier project participants to demand that payment procedures are followed by the upper tier parties reduces the effectiveness of the CCA. Thus the expected benefits of the provisions are not fully achievable. On the other hand, though the CCA is effective in resolving disputes faster, it does not seem to guarantee payment. The research therefore recommends that the CCA would need to incorporate a separate means by which payments can be secured for construction parties. Such payment securities could be in the form of the setting up of escrow accounts, issuance of payment bonds by upper tier parties etc. Legislative requirements to secure payments would not only guarantee payment but will also strengthen existing provisions within the CCA.

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