

# **LEGAL AND CONTRACTUAL CONDITIONS: IMPLICATIONS ON CONSTRUCTORS' SOLVENCY**

THANUJA RAMACHANDRA<sup>1</sup> and JAMES OLABODE ROTIMI<sup>2</sup>

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

*E-mail: tramacha@aut.ac.nz*

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

*E-mail: jrotimi@aut.ac.nz*

Often legal and contractual conditions stipulate payment terms for contracts which could impact on constructors' solvency. Evidence from different countries suggests that legal and contractual conditions have evolved or are evolving to cater for cash flow problems that could lead to insolvencies. However the review shows that in most countries payment terms specified in legislation are applicable only where contractual conditions have not been specified, while in some countries contract conditions become void if they violate legislative provisions. The UK Act requires fair payment regimes and adjudication to be in the contracts. Similarly, NSW and other Acts voids contract provisions that exclude payment rights.

Some of the legislation provides distinct features which could be considered upon contracting. For example the Queensland Act provides different payment due time for head contractors (within 25 business days of claim served) and subcontractors (within 15 business days of claim served). The Act of Western Australia and Northern Territory prohibits existing contract provisions of payment within 50 days of a served claim. Similarly, the latest Tasmanian Act prohibits the right to suspend the work if the party fails to make the adjudication within the stipulated time. The paper suggests that appropriate provisions of legislation need to be incorporated into contractual conditions since legislative provisions stand secondary to contract and available by default.

*Keywords:* Constructors' solvency, legislation, contract conditions, payment terms.

## **1 Introduction**

Constructors' solvency is very often determined by the timeliness and adequacy of the payment of issued invoices. Traditionally construction contracts provide contractual rights and obligations for parties to manage payment issues. However, the nature of the industry and its operational arrangements; unethical behaviour of professionals within the industry; market conditions e.g. recession causing insolvency, undue competitions etc; combine to cause problems associated with delay and non-payment in the industry. Late

and non-payment are therefore frequent practice that impacts on the solvency of construction participants.

There is no doubt that the widespread nature of payment problems in the industry in most of the developed countries, including New Zealand, is the driver to the enactment of construction payment specific legislation for the construction industry. These legislation (mostly in the form of Acts), in general, entitle parties to receive progress payment and pursue disputed progress payment by referring them to a rapid adjudication process. The Building and

Construction Industry (Security of Payment) Act 2009 (Australian Capital Territory) provide that an adjudicator's determination is binding upon parties and enforceable as a judgment. This provision together with the provision which relates to the practical implementation of the Act, requires a payment claim to state as follows: "This is a claim made under Security of Payment Act"; makes the Act tactical and an effective instrument in improving the payment problems experienced in the construction industry (Perigo, 2010). Chan (2006, p254.) believes that security of payment legislation is "a blunt but a practical and equitable instrument".

In New Zealand the Construction Contracts Act (CCA) 2002 was enforced in April 2003; to remedy the liquidation of several high profile construction companies due to non-payment by clients and developers; and to ensure regular and timely payment between parties. The CCA also provides for speedy resolution of disputes arising from building and construction contracts by the introduction of an adjudication process. Since the enactment of the CCA, the number of disputes referred to adjudication has increased with over 260 cases recorded by 2006 (Bayley, 2007).

Although these new security of payment legislation are widely recognized to tackle the late payment culture (Brand and Uher, 2008); this paper believes that there remains aspects of these legislation that could be improved upon. For example the adjudication provisions of the Acts is an interim solution and are subject to further review by a judgment in arbitration, litigation and agreement. This leaves respondents at a potential risk, as they may not be able to recover the adjudicated amount paid to a claimant. The respondent might experience this, if the final judgment is favourable but the claimant becomes insolvent by the time of the decision is arrived at (Ndekugri and Russell, 2005; Uher and Brand, 2006; Chan, 2006). However, this could be arguable as the

respondent is required to pay the adjudicated amount to the court or give a security pending final decision. In any case, this would not help to improve constructors' solvency. The extent to which an adjudicator's decision becomes effectively the final decision is questioned by Kennedy (2006). Further the nature of adjudication provisions of "pay now argue later", makes the dispute resolution process similar to traditional approaches like arbitration, and litigation.

The applicability of these security of payment legislation to lower tier construction participants is also in question (Brand and Uher, 2004 and 2008). Contractors and subcontractors seem not to be taking full benefit from these legislation, that are designed to benefit them. The tight timeframes stipulated in the Acts are another downside affecting the practicability of the Act. Winter and Slattery (n.d) explain that the extremely short timeframes for submitting payment claims, payment schedules and adjudications will make the South Australian, Building and Construction Industry Security of Payment Bill 2009 (not yet proclaimed) impractical.

Recognising these questionable provisions, this paper reviews the pros and cons of various Acts with a view to seeking improvements to payment problems in the industry. This approach is in line with the Chinese proverb: "understand yourself, understand your counterparts, you win 100 times out of 100 conflicts (Lau and Tang, n.d, p.39). The paper compares standard forms and legislative provisions so that it could suggest innovative improvements resulting from a hybrid of these existing legal and contractual provisions, thus facilitating constructors' solvency.

## **2 Payment Provisions: Security of Payment (SOP) legislation**

Table 1 presents a summary of payment related provisions that are available in SOP legislation enacted in some countries. In

general, the aim of the SOP legislation is to improve late and non-payment practices and/or to ensure regular and timely payments. In fulfilling these objectives, SOP legislation provides two main solutions: statutory payment right and the right in case of non-payment. These two provisions are in the following sub sections.

## **2.1 *Payment Rights in the SOP Acts***

Conditional payment provisions are a common feature in all the legislation reviewed, which could impact on the solvency of constructors. All the Acts except that of the UK have prohibited conditional payment provisions and made them unenforceable in any civil proceedings. This ensures a smooth flow of payment between parties and deprives the upper tiers from withholding payments to the lower tiers. The UK Act restricts the effectiveness of the conditional payment provision to only when there is insolvency in the payment chain. The CCA in NZ excludes this provision as an insolvency protection mechanism, as it enables contractors to be cautious about the financial status of the client while undertaking a project.

The time taken to settle claims raised by a contractor may impact on constructor's solvency. The Acts provide default time periods for payments varying from 10 to 28 days if no contractual provisions are available. The Queensland Act makes a distinction of 25 and 15 business days for the payment of contractors and trade/subcontractors respectively. The Singapore Act provides respondent a 7 days grace period (dispute settlement period) after the allowed response time, for respondents to vary the payment response or provide a payment response if one has not been issued previously. The Singapore Act limits progress claims to written construction contracts only.

## **2.2 *Rights in case of non-payments in SOP Acts***

All the Acts reviewed provide rights for disputes arising out of construction contract to be referred to adjudication in the case of non-payment. Adjudication determination is binding upon the parties, enforceable as a judgment in civil proceedings but it is viewed as an interim solution. This means that adjudication decisions are subject to alteration by a review adjudicator, or determined by a court or tribunal, at any other dispute resolution proceeding, or settled by an agreement between parties. The procedure for adjudication seems to differ slightly across countries. The UK and NZ Acts allow payment and non-payment disputes under contracts to be referred to adjudication while others allow only payment disputes. Although this does not affect timely payment and improving the solvency of constructors, except that the adjudicator's determination might take longer if non-payment disputes are also referred to adjudication. Another important feature which could impact on solvency is the provisions regarding the party that can refer payment disputes to adjudication. In the UK and NZ Act either party to a contract can commence an adjudication procedure while in other Acts only the claimant is entitled to do so. This is further restricted in Singapore Act where a claimant to a written contract is only entitled to commence the adjudication. This suggests that restricting the rights to the claimant can improve the situation, than letting any party to refer because Acts were expected to improve payment delays and losses to parties. Moreover, payment disputes seem to be due to money being withheld without notice/reasons, arbitrary devaluation, deliberate delays and non-payments, etc. For payment disputes, adjudication is generally available in three instances: when a claimant

does not receive money by the due date (in whole or in part), when the claimant disputes a payment response, and when a respondent fails to provide a payment response within the prescribed period.

Acts reviewed require adjudication determination to be made within 10-20 working days from the receipt of adjudication response. It would seem that 10 days is relatively short and that this could be impracticable in complex situations. An adjudication process may be extended further by the enforcement of an adjudicator's determination as a judgment debt in case of non-payment of an adjudicated amount and review, if the respondent is unhappy. In NSW, if a respondent applies to the court to have the judgment set aside; the respondent will not be entitled to bring a cross-claim against the claimant, or to raise any defence in relation to matters arising under a construction contract or to challenge the determination by the adjudicator. The NZ Act allows this by allowing a defendant to oppose the enforcement upon reasonable grounds within 15 working days from the date on which the defendant was informed about the application to enforcement. With the Singapore Act, a respondent can apply for a review, provided the disputed amount is in excess of \$100,000 of the response amount.

Finally, the reviewed Acts generally provide a party who carries out construction work under a construction contract the right to suspend work as a remedy for non-payment. This is permitted under three specific instances: claimed or scheduled amount not fully paid and failure to comply with an adjudicator's determination. However a claimant could exercise a lien over any unfixed plant or materials supplied; and to issue a charging order over the construction site in case of non-payment.

### **3 Discussion and Concluding Remarks**

Payment provisions and remedies for non-payments are well set out in payment

legislation and standard forms of contracts. If they are implemented properly the solvency of constructors are ensured by legislation. Legislative provisions stand secondary to standard contract provisions, which are available by default. This may make legislative provisions vain. Thus, Acts must require necessary provisions of the Act be included in the contract. For example the UK Act requires construction contracts to have adjudication provisions incorporated while the NSW Act makes contract provisions void if it overrides the Act. Similarly the Tasmanian Bill forfeits the right to suspend work, if the claimant fails to apply for adjudication within a given timeframe. The Western Australian Act recommends the prohibition or modification of certain provisions in the construction contract. The Western Australian Act requires the payment term in contracts to be changed to within 50 days after the claim is made instead of making payment more than 50 days after the payment claim is made.

The SOP Act in most countries have abolished "pay when paid" provision which enhances the solvency of construction parties as it prohibits withholding payments. The time taken to honour payment obligations from the date of serving the payment claim is served, seems fairly reasonable. The time varies from 20 to 30 days in NZ, Singapore, Queensland, Western Australia, and Northern Territory. This time is by default for progress claims which include final payments as well. It is quite obvious that final payment claims takes longer time to respond than progress claim. Alternatively, the time to honour payment response could be made more effective by providing two time limits as is the case with the Singapore Act. The Singapore Act provides a due date for payment followed by a final date. Alternatively by the Queensland Act, the time could be distinguished according to type of contractors; subcontractors and the types of payment; whether progress and final payment. It may even be possible to limit the time

frame to 20-30 days in all cases except in complex situations when the timeframe could be extended with the consent of parties.

The nature of an adjudication process raises two key issues. Firstly, adjudication determination is temporary and subject to alteration by a subsequent dispute resolution procedure. There are two potential problems envisaged. One is that a claimant does not receive an adjudicated amount immediately; it is being held in a trust account or given as a security. This does not augur well to constructors' solvency because it causes further delay and makes the adjudication determination time pointless. Thus the time to completion of adjudication should be considered up until the allowed review time. Also the likelihood of a change in adjudication determination exposes the respondent to the potential risk of non-payment, especially where the claimant becomes insolvent before the final decision on a dispute is reached. Secondly, the short time (10 business days) taken for adjudication determination seems unreasonable in complex situations, unless the dispute is anticipated and proper records are maintained.

With regards to payment rights the CCA and the standard contract conditions in New Zealand (NZS3910:2003) seem to be compatible from an implementation perspective. The few differences being the due times for progress and final payments; and intermediate notification of payment via provisional progress payment schedule. In case of non-payment, the CCA allows the aggrieved party to refer to adjudication, recover the amount in any court as debt and suspension. The New Zealand standard contract provides suspension, and subsequent termination, and ability to refer disputes to mediation, and arbitration. However the condition of contract does not restrict parties referring disputes to adjudication and it

specifies the other dispute resolution mechanism that parties could resort to.

## References

- Bayley, G., Construction adjudication in New Zealand under the construction contracts Act 2002, in 9th LEADR Intl. ADR conf. Wellington, New Zealand, 2007.
- Brand, M. C., and Uher, T. E., Review of the performance of security of payment legislation in New South Wales, in the RICS/COBRA conference 2008, Dublin, Ireland, 2008.
- Brand, M. C., and Uher, T. E., The performance of the Security of Payment Act in the Australian construction industry, in CIB world building congress, Toronto, Canada, 2004.
- Chan, P. C. F., Security of Payment Legislation - Case of a Blunt but Practical and Equitable Instrument. *Journal of Prof. Issues in Engrng. Educ. & Practice*, 132(3), 248-257, 2006.
- Kennedy, P., Progress of statutory adjudication as a means of resolving disputes in construction in the United Kingdom *Journal of Prof. Issues in Engrng. Educ. & Practice*, 132(3), 2006.
- Lau, E., and Tang, K.C., A review of the cost and time consequences of the standard forms of contract in the pacific region. Surveyors Times. Retrieved from <http://www.hkis.org.hk/>
- Ndekugri, I., and Russell, V., Insolvency and resolution of construction contract disputes by adjudication in the UK construction industry. *Constr Mngt and Econs*, 23, 399-408, 2004.
- Perigo, A., Security of payments in the building industry. *Contact Australasia*, 19 March, 2010.
- Uher, T., and Brand, M., A comparative analysis of the operation of compulsory rapid adjudication in New South Wales and New Zealand. *Constr. Mgt and Econ*, 25, 765-775, 2006.
- Winter, J., and Slattery. Building and Construction Industry Security of Payment Bill 2009. Retrieved 10 July 2010, from <http://www.jws.com.au/>
- Wu, J., Kumaraswamy, M., and Soo, G., Payment problems and regulatory responses in the construction industry: Mainland China perspective. *Journal of Prof. Issues in Engrng. Educ. & Pract.* 134(4), 2008.



**Table 1: Summary of Payment Provisions in Security of Payment Legislation**

No	Act	Purpose of the Act	Payment response	Dispute right (Adjudication)	Special Features
1	Housing Grants, Construction and Regeneration Act 1996 (UK Act) (the Construction Act).	Improving payment practices.	Money due notice is given to payee within 5 days of due date. Withhold/refuse payment" notice is given within 7 days prior to the final date for payment. Payment is made within 17 days from the due date.	Either party has a right to refer a dispute to adjudication (AD) and the decision is made within 20 working days of the referral, extendable if parties agreed.	Applies to written contract only. Payment and non-payment disputes referred to AD. Act requires all contracts must contain fair payment regimes and an AD procedure.
2	Building and Construction Industry Security of Payment (BCISOP) Act 1999	Reduce or eliminate payment delay.	Payment schedule is the response for the payment claim and the payment is made within 10 business days (BD) after the claim is made.	Claimant only can refer to AD and the decision is made within 10 BDs. Payment of AD amount is to be paid within 5 BDs of determination.	Disputes related to progress payments only referred to adjudication. Contract provisions cannot override the Act.
3	Construction Contracts Act (CCA) 2002 (NZ)	Facilitate regular and timely payment, speedy dispute resolution as a remedy for non-payment.	Same as above but the payment schedule and the payment is made within 20 working days of payment claim served.	Same as UK Act.	The Act is effective even if any provision in the contract is contrary to it.
4	BCISOP Act 2004 (Singapore Act).	Expediting payment and improving cash flow.	Payment becomes due for taxable claimant within 14 days of tax invoice is submitted to respondent. Otherwise within 14 days of payment response is required. The payment for supply contract is due and payable immediately after 30 days from the time of claim is made.	Claimant to written construction contract refers to AD and the decision is reached within 14 days from commencement. Review of AD determination is possible within 7 days of AD determination, permitted only when the adjudicated amount exceeds the amount set out in the payment response by a prescribed amount.	Applies to all written contracts and takes effect on payment when the contractual regime is silent. It does not affect any contractual payment regime. 7 days of grace period is given after due date as dispute settlement period.
5	BCISOP Amendment Act 2006 (Victoria Australia).	Entitlements to progress payments.	Same as NSW.	Same as NSW.	Same as NSW.
6	Building and Construction Industry Payments (BCIP) Act 2004 (Queensland Australia).	Same as above.	Payment is made for head contractor, trade and subcontractor within 25 BDs and 15 BDs from the time of claim is made respectively. Otherwise the provision is void and the contractor will be entitled to payment within 10 BDs from the claim served.	Same as NSW	Same as NSW.
7	CCA 2004 (Western Australia).	Ensure the money flowing in the contractual chain by ensuring timely payment.	Payment is made 28 days from the receipt of progress claim. If a party wants to reject or disputes the whole or part of the claim, the notice of dispute must be given within 14 days.	Either party to the payment dispute can lodge an application within 28 days after the dispute arises. Determination is made within 14 days of the service of the response to the application.	Act prohibits the payment term in contracts to be changed from making payment more than 50 days after the payment claim is made to within 50 days after the claim is made.
8	Construction Contracts (Security of Payments) Act 2004 (NT)	Same as NZ Act.	Same as above.	Same as above but the decision is reached within 10 days of serving the response to application.	
9	BCISOP Bill 2009 (Southern Australia)	Address the security of payment problem.	Same as NSW.	AD is lodged 10 BD after serving payment schedule. Decision is reached within 10 BDs after the acceptance to make adjudication or further time agreed by parties. The respondent has to make the payment within 5 BDs of decision.	Timeframes for submitting payment claims, payment schedules and adjudications are extremely short.
10	Tasmanian Security of Payment Act 2009.	Reform the payment behaviour in the industry.	For building practitioners, payment becomes due 10 BD after the claim is made and it is extended to 20 BD for the residential building owner.	Same as above but AD application is made within 20 BD if the respondent lodges a payment schedule and does not pay.	The right to suspension under the Act is forfeited if AD application is not lodged within the stipulated time.
11	Building and Construction Industry (Security of Payment) Act 2009 (Australian Capital Territory).		Same as NSW.	AD Application is notified to respondent within 20 BD following the due date for payment and the decision is reached within 10 days after the adjudicator receives the response from respondent.	