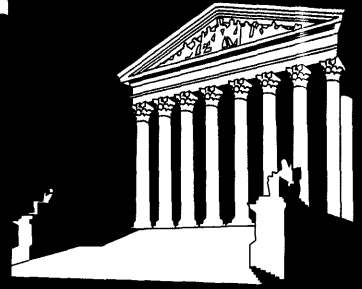


The Scheme for Construction Contracts



The draft Scheme for Construction Contracts has lately been released and will soon go through Parliament in the United Kingdom. The Scheme, introduced under the Housing Grants, Construction and Regeneration Act 1996, is the first significant intervention in the area of private contracts in the construction industry in the United Kingdom. This month we look at that Act and Scheme and the question of whether they offer any lessons for Hong Kong.

The Housing Grants, Construction and Regeneration Act 1996

The Act followed the report produced by Sir Michael Latham in July 1994 entitled *Constructing the Team*. The report was a joint government and industry review of both construction procurement and contractual arrangements in the construction sector. It was far-reaching and made significant recommendations including specific legislation to address certain practices which were said to be unfair. The UK Department of the Environment, (DOE), followed the recommendations with a consultation paper entitled *Fair Construction Contracts* to test some of the recommendations. In particular the DOE paper dealt with four issues: dispute resolution, rights of set-off, prompt payment and protection against insolvency. The debate moved from testing standard forms to testing all forms of contract against Latham's and later the DOE's minimum requirements. The Government took the views expressed into account and agreed to legislation but only in those areas where there was broad industry consensus. The result was a watered down piece of legislation but one that is still nevertheless significant because of its widespread application in the construction industry. The construction contracts aspect of the legislation was included in a piece of omnibus legislation that also addressed housing and regeneration topics. In short part II of the legislation provides a framework for fairer contractual arrangements and improved relations among those working in industry. It dealt with only two subjects: payment and adjudication. These provisions may be summarised as follows:

Payment and Adjudication in the Act

- Pay-when-paid= clauses, namely those clauses under which payment is withheld pending receipt of payment from a third party, are made ineffective save for third party insolvency situations.
- All construction contracts (as defined) must provide an - adequate mechanism- for determining the amount and timing of payments. Contractors are given a right to insist on interim payment for longer contracts with the date of final payment specified for each payment.
- Payers must give notice within 5 days of when a sum should fall due under a contract and how much he intends to pay. If the payer changes his mind he must issue a further notice of the amount being held within the time allowed.
- Parties are given the right to suspend work if payment is withheld without these notices being given.
- If payment terms and periods for giving notice to withhold payment are not specified in the contract then the terms and periods will be those set out in the Scheme for Construction Contracts.

Adjudication

The provisions on adjudication may be shortly summarised also:

- Parties to a construction contract may refer a dispute to an adjudicator.
- Contractual adjudication must be impartial and rapid. It must allow the adjudicator to operate informally and offer

immunity against legal proceedings. An adjudicator's decision is binding only until agreement, arbitration or litigation finally determines the dispute though parties may accept the adjudicator's decision as final.

- If there is no contractual adjudication agreement, or if it does not comply with these criteria, any party may use the adjudication procedures specified in the Scheme for Construction Contracts.

This is a short synopsis of Part II of the legislation containing the construction contracts legislation. Much however has been left out of it. In particular, recommendations concerning construction liability, trust funds, and interest on late funds were all dropped following the DOE consultation. One additional point is also worth noting; that is, the first draft Scheme for Construction Contracts that was released was withdrawn after considerable industry opposition.

The Scheme for Construction Contracts

The Scheme is currently divided into two parts: part I adjudication; and part II payment. The key features of the Scheme address the following topics:

- Adjudication
- Contents of the notice of adjudication.
- Appointment, capacity, failure to act, ceasing to act and revocation.
- Powers of the adjudicator.
- Jurisdiction, the decision of the adjudicator and enforcement.
- Effect of the decision and liability of the adjudicator.

Payment

Entitlement to and the amount of stage payments.

The dates for payment.

The notice of intention to withhold payment.

Prohibition of conditional payments.

Comment

The adjudication provisions fairly clearly address the main issues that will be expected to arise when invoking the procedure; however, the procedures should still only be viewed as the statutory minimum for the parties. The procedures seek to establish a quick flexible interim decision which the parties can then either accept, accept as the basis for further negotiation or reject and pursue their other remedies. Adjudication will of course be familiar to many under the UK subcontract provisions and locally under the ACP conditions of contract. The difference here is the breadth of the new jurisdiction for the adjudicator.

While it is unclear what effect the adjudication provisions will ultimately have upon disputes in general or upon relations in the industry the intention is that they will reduce the number of disputes that are eventually arbitrated. The hope is that the decision of the adjudicator will be accepted by the parties in more cases than not. It may be underscored that while adjudication is now being given as a statutory right many of the provisions envisage further details in the forms of contracts themselves and which will serve to govern in the first instance. Thus many details of the adjudication procedure can be thought of as only contractual and not statutory in nature. This may have an affect on compliance. For instance, the form of notice and how it should be served are left to the parties. Hence, it will only be in the absence of details by the parties that the default mechanisms in the Scheme would apply. The payment provisions seek to determine first of all what payments become due and when they become due. This is a means of reducing uncertainty. Given what should be reduced uncertainty as a result of the new requirements the intention behind the superior flow of information is to reduce set-off abuse. Better information coupled with the right of an adjudicator to award compound interest is intended to improve the lot of contractors. It may well do so if the intent is respected.

Lesson for Hong Kong

The Act and Scheme mark a dramatic departure from past policies of freedom of contract in the construction industry. Clearly it was thought following the report by Latham that there were significant problems in the UK construction industry. It can be observed that the private forms in use in Hong Kong suffer from the same deficiencies as those in the United Kingdom and which it was felt had to be addressed through legislation. A good case can be made that not only should these problems be addressed locally as well but that the reasons for doing so are stronger here given that the local private forms have not kept pace with these issues through amendments. While differences of opinion can be expressed over the mode of implementation the adjudication and payment measures deserve support. Shortly a new private form of contract will be released locally and it is hoped that those drafters have taken account of trends elsewhere including those under discussion here in framing the new terms. Adjudication and prompt payment are measures that deserve broad support in Hong Kong as well.

J.A. McInnis is an Associate Professor of Law at Hong Kong University and the author of Hong Kong Construction Law.

AAC