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Technical

How To Get Paid (Article 70)

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Introduction

Cash flow is critical for successful companies, but long payment terms and late payment in the construction industry are frequently reported as being endemic. A recent Government Report identified it was a commonly held view that late and non-payment is regarded as the "*norm*" (February 2020, Retention Payments in the Construction Industry, Department for Business, Energy & Industrial Strategy).

Long payment terms and late payment can have a damaging knock-on effect on a business' ability to manage cash flow and, in the worst case, threatens the survival of the business. This can impact on other organisations in the supply chain.

There is pressure on organisations, particularly smaller ones, to agree to long payment terms and accept unequitable financial arrangements or risk losing future work. Maximum payment terms of 120 days were introduced by a Contractor, which led to criticism from MP's, that large firms were abusing their position by effectively forcing suppliers to bankroll them.

There is also pressure on organisations to accept late payments as it is often perceived that the costs of recovering money through a formal dispute resolution procedure are disproportionately high.

There are frequent situations where, the party responsible for issuing the payment outright, refuses to pay the sums the receiving party considers to be due or pays less then was valued by the other party.

Late payment has an effect on a company's cash flow and ability to fund ongoing operations. The effects are then amplified when these payments are not made.

How Much is to be Paid and When?

In an ideal world, parties will have agreed payment terms prior to works proceeding, but it is often the case that works commence without any formal agreement having been made. This creates uncertainty about when payments are to be made or how much is to be paid.

Some payment certainty is introduced by the Housing Grants, Construction and Regeneration Act 1996, as amended by the Local Democracy, Economic Development and Construction Act 2009 ("*the Act*"). The Act requires construction contracts to include interim or stage payments. In circumstances where parties have not reached agreement on payment provisions, or a construction contract does not make adequate provision of dates for payment as required under Section 110 of the Act, the relevant provisions of the Scheme for Construction Contracts (England and Wales) Regulations 1998 ("*the Scheme*") shall apply. Effectively, the Scheme fills in the blanks and steps where adequate provisions in a construction contract are not provided. This ensures dates for payment are applicable and that Payment Notices have to be adhered to. Failure by the payer to comply with the Notice requirements may result in the default sum due being that claimed by the payee.

The Act also gives a Contractor the right to stop working when he has not been paid.

Payment Provisions of a Contract

It is crucial to be aware of the payment provisions in the Contract. The payment provisions, or lack thereof, can create barriers to prompt payment.

Before entering into a Contract, it is important that you are comfortable with the payment procedures. The Contract should include:

1. Payment Dates – The Contract should contain the following:
   a. Specified dates for submission of Applications for Payment/Invoices.
   b. Due Dates of payments (this is the date at which payment becomes due under the Contract; it is not necessarily the date that the payee will receive the money).
   c. Dates Payment Notices are required. The Payment Notice lets the payee know what sum will be received.
   d. Dates Pay Less Notices are required. The payer must issue a Pay Less Notice if it is to pay less than the notified sum.
   e. Final Date for Payment. The final date for payment is the date that the payer makes payment to the payee.
2. Breakdown of the Contract Sum - In situations where interim valuations or stage payments are to be made. The Contract should contain some form of breakdown to the Contract Sum. This helps enable a fair and reasonable valuation of the work executed to be undertaken. This could be a Bill of Quantities, Work Schedule, Priced Activity Schedule, a Contract Sum Analysis or a Stage/Milestone Payment Schedule.
3. Retentions – This is discussed separately in this Article. However, it is important that parties are aware of the sums or percentages which will be deducted as retention and when they are likely to receive the released retention. For example, if the Works Package is one of the first to complete on the project, are you going to have to wait until Practical Completion of the entire project prior to receiving the first tranche of retention monies? On a project spanning a long period, you may not be entitled to your retention monies for a number of years. There may not be transparency from the payer on attainment of Practical Completion to initiate the initial release of retention.
4. Final Account Procedures – The Contract will ideally set out the procedures that enable the account to be concluded, signalling an agreed amount that is to be paid by the payer to the payee. A final account effectively draws a line under the financial obligations of both parties, save for any defects that may arise. It brings about the finalisation of disputes over costs. An absence of final account procedures leaves the account open to future claims by the payee and/or reductions in value by the payer.

Once payment provisions are in place, it is imperative that the parties follow the contractual obligations. A failure to do so by the payee could affect their entitlement to payment. A failure to do so by the payer could result in a payment having to be made which is higher than it considers due. Submission of an Application for Payment by the payee, in line with the requirements of the Contract, may be sufficient enough for entitlement to the entire sums claimed should the payer fail to provide the correct notices on time.

Contracts often contain Payment Schedules to identify specific dates for submission of Applications for Payment, due dates, dates Notices are required and the final date for payment. Construction works can overrun for various reasons and may surpass the dates provided in the Payment Schedule. Unfortunately, the Act only requires payment to be made by instalments, stage payments or other periodic payments. The parties are free to agree the amounts of the payments and the intervals at which, or circumstances in which, they become due. Should the payments made previously under the Payment Schedule satisfy this requirement, the payer has fulfilled its obligations in terms of interim payments. Put simply, the payee may not be entitled to any further interim payments and may have to wait until the Works are complete to receive the remaining sums. To overcome this issue, where a Payment Schedule is incorporated into the Contract, it is important that this identifies if and/or how further interim payments are to be made after the dates in the Payment Schedule pass.

Retention Monies

Retention is typically a percentage of the payments made, that is held back as guaranteeing performance and for correcting defects. Retention periods and the sums/percentages to be withheld should be stated within the Contract. Commonly, the amounts withheld for retention tend to range between 1.5% and 5%, half of which is generally released upon Practical Completion and the remainder released once the Defects Certificate is issued.

Retention sums may appear to be small percentages when viewed in isolation, but they are often the profit margin for the Contract and the amount held at any one time across all contracts is significant.

A recent consultation report by the Department for Business, Energy & Industrial Strategy (Retention Payments in the Construction Industry, February 2020) identified perceived problems with "*the frequency of 'unjustified' late, partial and non-payment*". Prompt payment of cash retention was said to be unusual, and responses to the consultation identified there often being "*significant delays and/or non-payment of retention monies owed*". The responses also identified a "*prevailing culture of mistrust within the construction sector, with firms higher up the supply chain often utilising retentions as a lever in wider payment negotiations*" and firms seeking "*to delay payment or find means of dissuading sub-contractors from pursuing retention payments*."

Battling to get paid Retention Monies is something that can affect both Contractors and Sub-Contractors. It is sometimes possible for companies to pass the cost of retention on down the supply chain, but organisations at the bottom of the supply chain have no option to pass on any retention.

Unfortunately, once Retention Monies become due, there is no guarantee that the sums will be paid immediately or even paid at all. Delays or non-payment of retention can be down to a number of reasons; it could be due to a simple oversight by the payer or the personnel administering the Contract. This is especially so when obtaining the second half of retention as the Project Team is likely to have been dispersed. There may be delays in the issuing of the relevant Certificate, the payer may simply be breaching the Contract and refusing to pay the retentions or the payee may be faced with an insolvency upstream.

There are steps that can be taken to increase the probability that a payee with receive Retention Monies and reduce the likelihood of payment of retention being delayed:

1. Notify the payer immediately once it is considered that the relevant Practical Completion or Defects Certificate is due. A gentle reminder beforehand can prompt the payer to set the payment up ready too.
2. Keep a record of any correspondence with the payer of the retention that relates to the issuing of Certificates and/or payment of the Retention Monies. It is worth keeping a log of attempts to make contact, should the payer refuse to communicate. Tabling this evidence to the payer may be enough to persuade them to release the Retention Monies. It can assist later down the line also, should further action be required.
3. Negotiate specific late payment of retention terms and penalties into the Contract. These can be used to deter the payer from unnecessarily withholding Retention Monies after the relevant Certificates have been issued.
4. Seek further action against the payer through the dispute resolution procedures available.

A further way in which Contractors and Sub-Contractors can ensure they are not waiting for retention monies to be received, is to avoid it completely by way of a Retention Bond. A Retention Bond allows sums that would usually be held in retention to be paid to the payee, whilst providing assurance to the payer that the Works will be completed. Should Practical Completion not be achieved, or the Defects Certificate be prevented from being issued due to a fault of the payee, the payer may call on the Retention Bond to cover the cost of the outstanding works. Retention Bonds can have advantages for both the payer and the payee.

Further Action/Dispute Resolution

Unfortunately for a payee, agreeing satisfactory payment terms and then adhering to its contractual obligations does not guarantee that payment will be made on time or for the sums anticipated. However, for the payee there may be recourse through the various dispute resolution options available.

In the case of a missed Payment Notice by the payer (or a representative on their behalf), failure to then pay the sum considered due by the payee may be identifiable as a breach of contract. Should a payer provide the correct Notices and provide payment of the notified sum on time, but the sum paid by the payer is considerably lower than that considered due by the payee, this is considered a disagreement as to the value of works. In either case, there may be options available. Advice should be sought in order to establish what options are available, the merits of pursuing each option and the cost implications of such action.

Conclusion

To avoid unnecessary disagreements between parties over when payments are to be made, and how much is to be paid, it is important that payment provisions are agreed prior to works commencing. Payment provisions that are agreed must also adhere to the requirements of the Act. Should the agreed provisions not comply with the Act, or in the absence of adequate provisions it is important to know that the Scheme will fill the blanks, ensuring adequate provisions are available.

When it comes to retentions, ensure you comply with your contractual obligations, keep a record of communications and keep track of retention periods and dates when Certificates are issued.

Whether you are a payee struggling to receive the payments you consider due, a payer troubled over the sums being claimed by the payee or either party with concerns over your contractual obligations and/or requirements, there may be a number of options available to you. The earlier advice is sought, the better.