Section 1: Summary of RIA

Summary of Regulatory Impact Analysis (RIA)	
Department/Office: **Department of Public Expenditure and Reform**	**Title of Legislation:** **Construction Contracts Bill 2010**
Stage: Bill as passed by Seanad Éireann	**Date:** September 2011
Related Publications: N/A	
Bill is available to view or download at: http://www.oireachtas.ie	

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What are the policy objectives to be achieved?

- To ensure prompt cash flow improving efficiency; and
- To allow swift resolution of disputes by way of adjudication, allowing projects to be completed without wasting time and money in litigation.

What policy objectives have been considered?

1. Option 1: Do nothing

2. Option2: Legislative intervention to regulate payments between Contractors, Subcontractors and Sub-subcontractors (Construction Contracts Bill 2010)

3. Option 3: Consideration of possible amendments to the Bill as passed by Seanad Éireann

Preferred Option: Option 3

Section 2: Description of Policy Context and Objectives

Introduction

Construction is a very important sector of the national economy accounting for approximately 9% of GNP in 2010. It is widely acknowledged that well managed and successfully delivered construction projects can improve the delivery of public and private services. However, the economic downturn in the construction sector has highlighted the lack of formal contract arrangements and bad payment practices in the sector. While there is strong anecdotal evidence of the practice of delayed or non-payment having escalated in recent times, it should be noted that the problem is not new. It is reported that many firms, mainly SMEs, are experiencing serious difficulty in obtaining payment for work done. It is therefore important that where possible, payment transactions within this sector should be facilitated to ensure prompt payment of the correct amount.

Economic background

The Review of the Construction Industry 2009 and Outlook 2010-2012 carried out by DKM Economic Consultants Ltd. for the Department of the Environment, Heritage and Local Government shows that contraction in the construction sector is continuing. The Review and Outlook states that the construction sector activity peaked in 2006 with total output accounting for approximately 25% of GNP. Since then the construction sector has seen its share of GNP decline to 13.8% (or €18 billion) in 2009 and was estimated at 9% (or €11.7 billion) of GNP at the end of 2010.

In addition, the latest seasonally adjusted employment data[1] shows that numbers employed in the construction sector have declined from 181,400 in first quarter of 2009 to 108,100 in first quarter of 2011.

The DKM Review and Outlook also states that every sector of the construction industry has been affected by the current challenging economic environment. All housing indicators are weak following a period of rapid contraction over almost four years. There are a number of issues impacting on this sector, such as continuing high debt levels, difficulties securing finance, excess capacity, and a lack of consumer confidence. This very challenging market has led to an increase in corporate failures in the construction

[1] CSO - Quarterly National Household Survey, Quarter 1 2011.

industry, with construction firms accounting for four out of every ten business failures in the first six months of 2010.

Problem of delayed or non-payment practices in the Construction Sector

Given the economic backdrop and the difficulties being encountered in obtaining credit it is not surprising that there is strong anecdotal evidence indicating that many parties in the construction sector are increasingly facing problems of delayed or non-payment for work done. While this problem has always been there it has never been at the scale currently being experienced. The issue of delayed or non-payment in the construction industry can be attributed a variety of factors, such as: the structure of the sector which involves long value chains of economic operators (e.g. client, consultant, main contractor, several sub-contractors, potentially many sub-sub-contractors, suppliers to all contractors and sub-contracts); the lack of credit; the sharp downturn in business levels in the sector over the past couple of years and insolvency of many key players; increased competition for business as a result of a shrinking market leading to aggressively priced tender bids; and anecdotal evidence of an industry culture which seems to be more tolerated than other industries of practices such as oral contracts and in some cases "pay when paid clauses", lack of clarity on payment dates and in some cases deliberate non-payment or slow-payment arrangements being common in the sector. This means that firms anxious to win work can get themselves into situations where they are very exposed to the practice of delayed or non-payment for work satisfactorily done over long periods of time .

Consequences of delayed or non-payment practices in the Construction Sector

Most disputes under construction contracts relate to the issue of payment. Such disputes can sour relationships and pose a major threat to the effective delivery of projects on time and on budget.

In addition, bad payment practices in the construction industry can give rise to substantial additional financing and transaction costs as well as consuming considerable skilled resources in dealing with disputes over payment that could otherwise be put to productive use. More importantly, certainty over time and amount in regard to payment builds trust between supply team members leading to improved working relationships which underpin collaborative working resulting in achieving better value for money for projects that are delivered more efficiently.

Rationale for Government intervention

The present arrangements in relation to construction contracts and conditions of engagement are (apart from a small number of formal standard forms of contracts and conditions of engagement) far too imprecise and informal and as a result do not offer a cost effective, timely solution for consultants, contractors, subcontractors and suppliers in the supply chain. The Bill that is before the Dáil proposes State intervention by creating a regulatory framework to provide for minimum contracts terms regardless of whether the contract is written or oral. It also allows for a speedy review and resolution of construction contract payment disputes as they arise.

Arising out of demands from businesses on all sides of the construction industry and from parties outside it, it is evident that there is a need to set up on a statutory basis a requirement for minimum contract terms and review procedures to be included in construction contracts that address two main aims:

1. to ensure prompt cash flow improving efficiency (amount and timing of payment); and
2. to allow swift resolution of disputes by way of adjudication, allowing projects to be completed without wasting time and money in litigation.

In this regard, it is Government policy to introduce new legislation to protect contractors that have been denied payments from parties further up the supply chain owing them money without placing an unnecessary regulatory or cost burden on the parties to the dispute, other parties involved in the project, or the State.

Section 3: Identification and Description of Options

This section examines the three options that could be considered in relation to the issue of delayed or non-payment in the construction sector. The main sources of data available on this topic relate to the size of the construction sector in Ireland and the numbers that are employed by the sector. There are very few other sources of data available in relation to the actual number of construction contracts that exist at any given time, the nature of the contracts (i.e. the percentage that are entered into under formal or informal contractual arrangements) and the average number of contracts that end up in dispute. Furthermore, as dispute resolution procedures are confidential there is no information on the types of dispute that are referred to conciliation or arbitration for resolution, the duration of these disputes and the costs associated with them. Therefore, the analysis in this section is based on the consultation with the stakeholders in the Irish construction sector and on data compiled in the UK based on the experience of the operation of Part II of the Housing Grants, Construction and Regeneration Act 1996[2]. In the case of the latter, it is appreciated that there are significant structural differences between both jurisdictions nonetheless the data compiled on the UK is useful in terms of illustrating the potential impact of such legislation.

The remainder of this section will examine three options for regulatory intervention in regard to payments under construction contracts. These options are:

1. Do nothing (no regulatory intervention);

2. Legislative intervention to regulate payments between Contractors, Subcontractors and Sub-subcontractors (Construction Contracts Bill 2010); and,

3. Consideration of possible amendments to the Bill.

[2] Commenced by S.I. 1998 No. 649 The Scheme for Construction Contracts (England and Wales) Regulations 1998

Option 1. Do nothing (no regulatory intervention)

A Nature of contractual arrangements

In examining the options available to regulate payment arrangements and dispute resolution procedures in the public and private sectors it is necessary to consider the nature of the contractual arrangements between the various parties involved in a construction project.

In the case of the public sector there are numerous obligations attached to public expenditure that a public body must comply with in order to correctly spend taxpayers' money on a construction project. These include compliance with: the Capital Works Management Framework including Public Procurement legislation and policy; Government Accounting Standards; Public Financial Procedures; Internal Audit standards; legislative provisions that set out the obligations of Accounting Officers and accountable persons.

In addition to these financial obligations public bodies are required as a matter of Government policy use a standardised suite of construction contracts and conditions of engagement. Whilst the main objective of the suite of contracts and conditions of engagement is to eliminate, as much as possible, cost over-runs and to achieve greater value for money for the taxpayer, they also ensure that any expenditure on construction takes place under a formal contract. The dispute resolution procedures provided for under these contracts is outlined later in this section.

In the case of the private sector contracts and those on lower tiers to public sector contracts there is more scope for informal contractual arrangements. Expenditure on construction can be conducted on the basis of very simple contracts such as a short handwritten note, or letter, or even on a verbal basis. This means that a contractor[3] can be engaged on a project without knowing the precise conditions for payment (i.e. no formal contract that sets out the timing and amount of payments over the course of a construction project). On this basis subcontractors may only get paid at the end of a project or when the main contractor has been paid ("Paid when paid" clauses). In such cases a contractor is more vulnerable to non-payment depending on the financial stability of the main contractor or client. If regulations were in place that provided for

[3]Where this term is used in this section it can also mean subcontractors, sub-subcontractors and suppliers.

minimum contracts terms this would significantly reduce the contractors' exposure to large payment defaults at the end of a project.

In addition, informal contracts can mean that contractors who are in dispute about payment on a project cannot use the formal dispute resolution procedures that are normally only found in standard formal contracts.

Whilst it is appreciated that professional bodies in the construction sector also offer a standardised suite of construction contracts, it is understood that these are mainly used at the top tier in private sector.

Dispute resolution procedures in the Private Sector are examined under B below:

B Dispute resolution procedures in the Private sector

If there is an issue regarding non-payment in most (commercial) contracts, the aggrieved party can seek enforcement of the disputed amount as a debt by means of a court order. In the case of private sector, standard forms of construction contract, there are alternative dispute resolutions provisions included in them which allow for conciliation and arbitration to be used instead of having the matter resolved by the courts. While these dispute resolution mechanisms are effective (having regard to the technical complexity of many disputes), they can be very slow, or in the case of conciliation lack enforceability, and in the case of arbitration, very expensive. The Prompt Payment Act may also be utilised by suppliers of goods and services (including construction works) in order to be paid interest on any payment amounts outstanding after the payment date.

Conciliation (Private sector)

Conciliation is a process whereby the conciliator seeks to facilitate a settlement between the parties. In the case of the Irish construction industry the procedures for conciliation are defined by the industry and by the relevant professional bodies. Construction contracts normally set out the broad framework and key terms for conciliation and provide for the conciliator to be appointed by agreement between the parties or failing agreement by the parties by a specified organisation or professional body in the contract.

The length of time provided for conciliation can vary depending on the procedure followed. Under the Engineers Ireland conciliation procedure, the conciliator is obliged to conclude the process within forty-two days of his appointment unless the parties agree otherwise. There is no overall time limit specified in the RIAI procedure but it is understood that conciliations under that procedure are usually concluded within two or three months.

In terms of cost, it is understood that the common practice is that each party bears its own costs and pays one half of the conciliators fees irrespective of the outcome. Though no data is available on this issue, it is understood that the fees for conciliation are less than Court Litigation or Arbitration and because the procedure is much quicker it costs less.

If the parties reach settlement, that settlement is signed off by the parties. It then becomes final and binding. If settlement is not achieved, and the conciliator issues a recommendation, that recommendation will become final and binding between the parties unless one of them rejects the recommendation within a specified number of days. In general**,** the entire procedure is to be regarded as confidential and neither party can refer to anything that occurred in the conciliation or call the conciliator as a witness in any proceedings.

Arbitration (Private sector)

Arbitration is a process underpinned by legislation whereby parties agree to refer disputes between them for resolution to an independent third party known as the Arbitrator. The Arbitrator works to rules agreed between the parties (for example, terms that maybe included in a contract) or, if no such rules are agreed, as laid down by the Arbitration Act 2010.

Arbitration is similar to court litigation in that it usually involves pleadings and a full hearing based on the law of evidence applicable to Court proceedings. The appointment of an Arbitrator is either agreed by the parties or appointed by an organisation or professional body named in the contract.

Arbitration is a complex and often lengthy process taking from months to years to complete depending on the nature of the dispute. This timeframe allows for full pleadings, disclosure of documents, witness statements, evidence etc. Arbitration costs are roughly the same as litigation before the Courts. There can be savings in some elements but they are offset by the fact that the parties have to pay for the Arbitrator and the venue but not for the judge or the Court. An Arbitrator has the same powers as a judge to award costs against an unsuccessful party. However, as arbitration is a private process which the parties themselves and the Arbitrator are obliged to keep confidential, no data is available on the process.

An Arbitrator's award is final and binding and cannot (except in very exceptional circumstances) be appealed to the courts.

Dispute resolution procedures in the Public Sector are examined under C below:

C Dispute resolution procedures under Public Works Contracts

There are two levels of formal intervention to aid resolution of disputes in the public works contract that operate at the top tier. These formal intervention arrangements are not normally available to sub-contractors and suppliers further down the supply chain.

Conciliation (public works contracts)

When a dispute arises under the Public Works Contract, either party (the Employer or the Contractor) may refer the dispute to conciliation for resolution or recommendation. There is an obligation on those in dispute to jointly appoint an independent conciliator within ten days. If the parties cannot agree to the appointment of a conciliator, the person or body named in the Schedule (Part 1N) appoints the conciliator. These proceedings are confidential. The parties send the conciliator details of the dispute and provide each other and the conciliator with documentation and any other evidence the conciliator needs to consider.

In facilitating the resolution of the dispute, the conciliator may meet with the parties, take legal advice or use professional advisors. The time limit for normal resolution of a dispute is 42 days or a longer period can arise if so proposed by the conciliator

and agreed by the parties. In the event that a dispute is still unresolved, the conciliator issues a written recommendation at the end of the 42 days (or longer period, if agreed). If either party is not satisfied with the recommendation, they must notify the other party within a further period of 45 days. Otherwise, the conciliator's written recommendation becomes binding on the parties, and any payments recommended by the conciliator should be made.

If the party who is required to make the payment remains dissatisfied, they should issue a "notice of dissatisfaction" and may make the payment subject to the receipt of a bond[4] for that amount provided by the other party. The purpose of the bond is to cover the eventuality that the final resolution of the dispute (by arbitration) might reverse the conciliator's recommendation. The conciliation process is now complete, and the dispute (if unresolved) moves to arbitration.

Arbitration (public works contracts)

Where conciliation does not resolve the dispute, the Public Works contract provides for the matter be referred to arbitration for final determination. Disputes not resolved by conciliation are referred to arbitration under the arbitration rules set out in the Schedule (Part 1N) to the Public Works Contract[5]. A party may commence arbitration proceedings by giving to the others a notice to refer the dispute to a sole Arbitrator in accordance with the contract. No party may disclose to the Arbitrator anything said or done at conciliation, its outcome, or (except in proceedings dealing with interest under rule of the arbitration rules) any payment made under a conciliator's recommendation. The party giving the notice to refer is known as the referring party and every other party to the arbitration is referred to as a respondent.

There are a series of procedures for the selection of an Arbitrator. The Arbitrator may conduct the arbitration in the manner the Arbitrator considers appropriate subject to the arbitration rules and the law.

[4] The bond arrangement under conciliation only applies to PW-CF1 to PW-CF5 Contracts.
[5] The resolution of disputes under the Short Form of Contract (PW-CF6) is dealt with by conciliation or the courts.

Once appointed an Arbitrator should hold a meeting with the parties. The Arbitrator applies the burden of proof according to the law. The Arbitrator has the power to decide all procedural and evidential matters. Hearings shall be private unless the parties agree otherwise.

The arbitration should initially be conducted according to the short procedure unless such a procedure would interfere with due process and all the parties agree or the Arbitrator, on the application of a party, that it should not apply because of the complexity of the issues. Within 30 days after the preliminary meeting held or within 30 days after the respondent has sent its statement of defence (whichever is later), the parties shall agree and provide a file to the Arbitrator containing the required materials. Within 30 days the Arbitrator shall either make the award or schedule a meeting for the parties. If a meeting is held, the Arbitrator should make the award within 30 days after the end of the meeting.

In addition, to making a final award, the Arbitrator will be entitled to make interim awards. The Arbitrator will make each award in writing and promptly send it to the parties. Awards of the Arbitrator will be final and binding on the parties. The parties undertake to carry out the Arbitrator's awards without delay. In addition, the Arbitrator will have the power to award interest in accordance with the contract and the law.

The costs of the Arbitration process are borne equally between the parties in accordance with the Arbitration Act 2010 which allows for Contracting Authorities under Section 21 to put in place pre-dispute agreements in relation to costs of arbitrations. A pre-dispute agreement is included in the Form of Tender (FTS1-5).

D Prompt Payments legislation

In addition to the contractual remedies outlined above the issue of late payments in respect of contractors, sub-contractors and suppliers is regulated by the European Communities (Late Payment in Commercial Transactions) Regulations 2002 (S.I. No. 388 of 2002). Prompt payment legislation is the responsibility of the Department of Enterprise, Jobs and Innovation.

The Regulations provide that where a purchaser does not pay for goods or services by the relevant payment date, the supplier shall be entitled to interest ("late payment interest") on the amount outstanding. Interest shall apply until such time as payment is made by the purchaser. In the absence of any agreed payment date between the parties, late payment interest falls due after 30 days has elapsed. The 2002 Regulations also provide for compensation for debt recovery costs. The enforcement of contractual rights, including any rights and obligations provided for by the Regulations, is a matter for individual suppliers. The regulations do not provide for any enforcement role for the Department of Enterprise, Jobs and Innovation.

In the case of supplies to the Construction Sector, it would appear that the Prompt Payment regulations are effective when the debt is not disputed. In the case were the debt is disputed, all the dispute resolution procedures must be exhausted before the debt is enforceable under the Prompt Payment regulations. In some instances it may take years to determine the quantum of payment due.

A more recent Directive 2011/7/EU "Combating Late Payment in Commercial Transactions" was passed by the European Parliament on 16 February 2011. This Directive establishes specific deadlines for the payment of invoices and the right to compensation in cases of late payment in all commercial transactions irrespective of whether they are carried out between private or public undertakings or between undertakings and public authorities. Member States have until the 16 March 2013 to transpose this legislation.

Costs of Option 1

- There are no direct additional financial costs to the State of maintaining the status quo.
- However, under the current system the market is not working properly or running as efficiently as it should. These inefficiencies may lead to payment disputes; project delays and a protracted dispute resolution process which add to the cost of completing construction projects.
- It is understood that a significant number of firms, mainly SMEs, are experiencing difficulty in getting paid for work. The current lack of rules or regulations for construction contract payments means in many cases there are no formal contracts

which leaves the party owed money open to large payment defaults at the end of projects and no formal means of addressing payment disputes when they arise.

- Where such contracts are in place the only routes for resolution of such disputes is either by conciliation; arbitration or through the Courts. None of these options offer a cost effective or timely solution for subcontractors.
- It could be argued that the current systems for resolving payment disputes can provide an opportunity for a party to frustrate (timely) payment by manufacturing a dispute. This lack of balance in the regulation of basic contract or payment provisions in construction contracts gives the party owing money significant power over when that money should be paid.

Benefits of Option 1

- No additional cost to the Exchequer of setting up and maintaining the relevant structures with the necessary administrative back-up that would be required to resolve such disputes quickly;
- In the main, parties have the freedom to enter into whatever contractual arrangements they wish unless specific restrictions apply (for example; in the area of employment law); and
- No cash-flow problems that may ensue from contractors being denied the ability to provide 'pay when paid' clauses into contracts or having to adhere to a minimum timeframe for paying subcontractors.

Impact of Option 1

Consultations have revealed that a significant number of firms, mainly SMEs, are experiencing difficulty in getting paid for work. Late payment represents a significant cost to business e.g. impacting on cash flow; adding financial costs; squeezing investment opportunities; and, fuelling uncertainty for many businesses, in particular, SMEs, especially in times of limited and expensive access to finance. The result is that their competitiveness and solvency are often compromised. The risk of such negative effects strongly increases in periods of economic downturn when access to financing is more difficult.

Option 2. Legislative intervention to regulate payments between Contractors, Subcontractors and Sub-subcontractors (Construction Contracts Bill 2010)

Description of proposed Legislation

The primary objectives of the legislation are:

- to provide for minimum contract provisions that improve prompt cash flow efficiency; and
- to allow swift resolution of disputes by way of adjudication, allowing projects to be completed without wasting time and money in litigation.

It aims to achieve this by providing for:

- a right to interim, periodic or stage payments, making clear when payments become due, their amount and a final date for payment;
- a statutory right for the payee to suspend performance where a 'sum due' is not paid, **or** properly withheld, by the final date for payment;
- the prohibition of "pay when paid" clauses which delay payment until it is received by the payer.
- a procedure for parties to a contract to make a payment claim;
- a statutory right for parties to a construction contract to refer payment disputes to adjudication;
- an adjudication procedure to deal quickly with disputes about payments. The adjudicator's decision will be binding, unless appealed to arbitration, and payment, if any, must be made to the party named in the decision.
- a panel of adjudicators will be set up and administered by the Department of Finance.

A copy of the Bill that passed all Seanad Stages is attached at Appendix A.

Costs of Option 2

The cost to the Exchequer should be limited, as the cost of the Adjudicator appointed from the national panel plus the cost of the adjudication process will be borne by parties to the dispute. The limited costs to the Exchequer will involve a small administrative cost to the Department of Public Expenditure and Reform in relation to appointing a panel chairperson to continuously maintain a panel of approved adjudicators and to make nominations from the panel from time to time. There would also be additional costs in relation to providing a secretariat for the chairperson and also for ongoing accommodation requirements and for advertisement costs, etc.

In relation to the main costs of this option which will be borne by the parties involved in a dispute, while there is little available data on the potential costs in Ireland, data from the UK[6] offers some insight[7] into these costs based on a potential level of claims, hourly rates charged by adjudicators, etc. The most recent report[8] (June 2010) shows:

Hourly fees charged by adjudicators

The data collected for the reporting period (2004-2008) shows that the largest group of adjudicators in the UK were charging between £151 - £175 per hour in 2008. This was closely followed by the hourly charge-out rates of between £126 - £150 and £101 - £125 for the next largest group. The most commonly charged rate in 2007 was £126 - £150. Anecdotally, it is understood that equivalent rates in Ireland would be higher. It is understood that the hourly rates quoted in the reporting period would be similar to the level of fees paid for conciliations services in Ireland.

Time taken by adjudicators

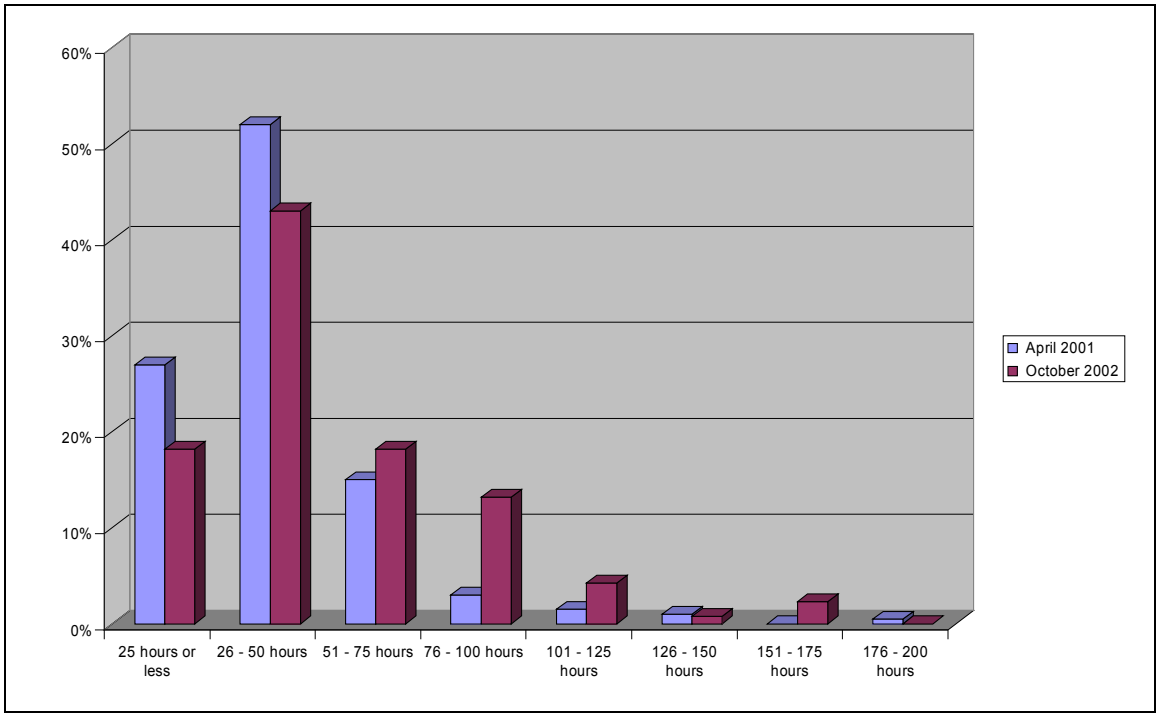
[6] Following the introduction of the Housing Grants Construction and Regeneration Act of 1996, Glasgow Caledonian University set up a UK wide Adjudication Reporting Centre which could gather data on the progress of adjudication and disseminate this back to the construction and property industries. This has been supported by the Adjudication Nominating Bodies (ANBs) which are asked periodically to complete a detailed questionnaire and return it to the Centre.

[7] It should be borne in mind that not only are there considerable differences between the comparative size / value of the markets in Ireland and the UK, potential number of disputes, etc., but there may be a number of other 'unknown' variables which may impact on the comparability of the data, e.g. levels of compliance in the sector, size of the hidden economy.

[8] Research Analysis of the Progress of Adjudication based on returned questionnaires from adjudicator nominating bodies (ANBs) and from a sample of Adjudicators, Report No. 10, June 2010. Adjudication Reporting Centre, Glasgow Caledonian University

There is no recent data on the time taken by adjudicators for each adjudication; however, it was addressed by a study in 2003[9] which found the distribution to be as shown in Figure 1. The numbers taking between 26 and 50 hours were the most common, followed equally by those taking less than 25 hours and those taking 51 to 75 hours. The study found that there was a shift from relatively simple adjudications to those which are more demanding and which require more time to complete and which "continues the trend which was reported in Report No 4 where it had already been stated that there was a large reduction in the number of disputes taking less than 20 hours to reach a decision."

Figure 1 Hours spent by adjudicators for each adjudication



Compliance with time limits

Timescale for adjudication	2001	2004	2005	2007	2008
Decisions given within 28 days	69%	60%	58%	47%	56%
Between 28 and 42 days	27%	30%	32%	39%	36%
More than 42 days	4%	10%	10%	14%	8%

[9] Research Analysis of the Progress of Adjudication based on returned questionnaires from adjudicator nominating bodies (ANBs) and on questionnaires returned by Adjudicators, Report No. 5, February 2003. Adjudication Reporting Centre, Glasgow Caledonian University

Benefits of Option 2

As outlined in Section 2, the issue of non-payment in the construction sector is particularly evident in the present economic climate. While non-payment is associated with a variety of factors, it would appear that the present systems for the resolution of such disputes by arbitration or through the Courts are not efficient, timely or cost effective, particularly for smaller projects.

The proposed Bill creates a regulatory framework for review and resolution of payment related construction contract disputes, with the aim of achieving this without placing an unnecessary regulatory or cost burden on the parties to the dispute, other parties involved in the project, or the State.

Impact of Option 2

The Bill will have a significant impact in two key areas, namely:

National competitiveness / improved efficiency in the construction market

The objectives of the legislation are to ensure prompt cash flow improving efficiency and to allow swift resolution of disputes by way of adjudication, allowing projects to be completed without wasting time and money in litigation. The proposed legislation should enable a significant sector of the economy (approximately 9% of GNP) to operate more efficiently which could be beneficial to the Exchequer.

Safeguarding of Public Monies

The non-binding nature of the adjudication process, safeguards the public interest as it would not expose the State to pay for awards which were awarded by an Adjudicator and which were subsequently overturned by Arbitration. If this was not the case and the State paid an award on foot of a decision by an Adjudicator, it might prove difficult for the State to recover that money. While this issue will be examined later in this section, it is worth noting that Public works contracts already contain provisions that require awards granted as part of the conciliation process to be bonded in the event that the conciliators decision is overturned in Arbitration. This clause in public contracts may provide a solution in terms of firming up the provisions in the legislation in relation to the nature of the adjudicators' award.

Option 3: Consideration of possible amendments to the Bill

The Seanad debate on the Bill and the subsequent consultation raised a number of 'technical' amendments[10] which do not represent a significant shift in the overall policy rationale for regulatory intervention and therefore do not form part of the regulatory impact assessment of the Bill.

However, there are four main proposals some of which are inter-connected that would have a fundamental effect on the impact of the legislation. These proposals which were raised in the Seanad debate on the Bill and as part of the consultation process are:

- The inclusion of a provision that would guarantee payment under a construction contract through the use of a financial instrument such as a bond or designated trust account;
- The removal of the minimum monetary thresholds that put private sector contracts under €200,000 and public sector contracts under €50,000 outside the scope of the legislation;
- To make the adjudicator's award binding on both parties regardless of whether the dispute goes to Arbitration; and
- To broaden the scope of the Bill to include goods and products specially manufactured for a project.

Inclusion of Security provisions

The inclusion of security provisions in construction contracts would fundamentally change the regulatory impact of the legislation and although there may be merits in including such provisions, their inclusion is likely to increase the regulatory burden and costs associated with contracts between clients, contractors, subcontractors and the final consumer.

The cost of providing security, through bonds, is likely to be high given current economic conditions. The inclusion of such a provision could be counter-productive as it may have the unintended consequence of further deteriorating the cash flow for smaller contractors by tying up limited resources in security instruments. It is likely that this additional cost

[10] It is understood that these issues will be examined by the Department of Public Expenditure and Reform before the Bill goes before the Dáil.

would reduce the number of players in the market and lead to an increase in the price for construction related services that would result from reduced competition.

Furthermore, it should be noted that data on the extent of the non-payment problem in the sector is not available due to the informal nature of certain construction transactions, combined with the confidential nature of current dispute resolution procedures where formal contracts are in place. Therefore much of the information on this topic is either anecdotal or received as part of the consultation process on the Bill. In this regard, the consultation raised some contradictory points on the size of the non-payment problem versus the cost of insuring against it. Whilst it was argued that non-payment was common in the sector, it was also argued that insuring against such payment practices would not be costly. In the absence of data on this issue, it is difficult to reconcile these points. It would seem appropriate therefore to include some form of data collection requirement in the legislation which could be used in a future review of the legislation.

Given the potential drawbacks of including in the legislation a provision for a financial instrument such as a bond to provide security for interim and final payments to be put in place and the lack of available data it is difficult to gauge whether such a regulatory intervention is a proportionate solution to the problem. If the vast majority of construction projects are operating in accordance with the provisions set out at the beginning of a project; is the imposition of costs associated with additional mandatory security requirements necessary or economically sustainable? Such regulatory intervention could merely shift the cost related to the risk to the end consumer in this case the public or the taxpayer in the form of increased overall construction costs.

In the absence of a financial instrument that would safeguard interim and final payments, are there ways of reducing the exposure of contractors to non-payment? In considering this issue it is worth looking at some of the main problems that lead to contractors and subcontractors being exposed to non-payment. These problems would include:

- In many cases construction contracts are carried out on an informal basis. (i.e. through oral agreements, letter or even notes). Such transactions are based on good faith which leave the contractor open to under/non payment;
- Even in cases where the parties to a construction project have a formal contract in place, there is no regulatory requirement to include the amount and timing of

payments under the contract. This means that the (sub)contractor may have to wait until the end of a contract to be paid;

- Payments to contractors under private sector construction contracts can rely on the sale of a property to a third party ("paid when paid" clauses) which means that a sub-contractor has to wait on the sale of the property before he/she gets paid. This practice represents a gamble for the sub-contractor as the amount they get paid and the timing of such payments are subject to prevailing market conditions.
- Current arrangements for resolving payment disputes under formal construction contracts can be time consuming and costly to both parties. This is likely to act as a disincentive for either party to engage in a formal dispute resolution procedure. In such cases it is likely that the subcontractor will accept a reduced payment to resolve the dispute quickly.

In this regard, there are provisions in the Bill that; provide minimum standards for all contracts regardless of whether they are in writing; prohibit "paid when paid" clauses; and, introduce a system of adjudication to resolve payment disputes in a timely and efficient manner. These provisions significantly reduce the exposure of subcontractors to non-payment which in turn reduces the necessity to require all construction contracts to purchase payment insurance or bonds.

Notwithstanding the above, in the case of public contracts if the Bill was amended to recognise the concept of 'project bank accounts' as accounts set up under public contracts for the purpose of providing payment security specifically leaving the details of regulating the accounts to the contract rather than legislation, then the issue of security would be addressed in the public sector. The additional cost for this measure is likely to be minimal, given that banks derive their income by lending money on deposit (which is guaranteed) in their accounts to approved borrowers. Also project bank account transactions costs may be neutral as such costs already exist in a range of bank accounts currently being used by those in the supply chain.

Type and size of Contracts (Thresholds included in the Bill before the Dáil)

The Bill currently does not apply to contracts below certain value thresholds, and will not apply to contracts in respect of an individual's residential dwelling, provided it does not exceed a certain size. It was considered that applying the legislation to contracts below these levels would place a disproportionate regulatory burden on the parties to the contracts. The following are the categories of contract which are excluded from the Bill:

- where one party is a State entity, and the contract is less than €50,000 in value;
- in other cases (i.e. no State entity involved), and the contract is less than €200,000 in value; and
- If the contract relates to a dwelling up to 200 square metres which is/will be the residence of one of the parties to the contract.

The key consideration is to strike a balance between having a proportionate and fair regulatory burden and ensuring that the Bill is effective in achieving what it sets out to do i.e. to help address the issue of non-payment in the construction sector.

However, during the consultation it was argued that these thresholds were too high as contracts under these thresholds accounted for approximately 50% of all the contracts. In addition it is apparent from analysis of the UK[11] experience of adjudication that the majority of disputes that use such processes are in relation to contracts valued between £10,000 and £50,000.On balance it would appear that these thresholds should be reviewed.

Non/binding adjudication in the event of arbitration

The consultation raised the argument that the legislation in its present form undermines one of the key objectives of the Bill i.e. to allow swift resolution of disputes by way of adjudication, allowing projects to be completed without wasting time and money in litigation. Specifically, it was proposed that the non binding nature of the adjudicators' award weakens the process and would give rise to prolonged and costly payment disputes.

[11] Adjudication Reporting Centre – Report 10 June 2010

This is a key consideration as there is a need to strike a balance between ensuring the efficient operation of the construction sector in Ireland, both in terms of resolution of payment disputes and the safeguarding of public monies. As the legislation is currently drafted, the balance favours the payer.

An alternative that could be considered would be to have a two pillared approach, with differing arrangements for public and private contracts. Adjudication would be binding for both the public and private sectors. However, the public sector would preserve the arrangements already in place in public works contracts that require such awards granted under the current conciliation process to be covered by a bond in the event that the conciliator's decision is being challenged and is subsequently overturned in Arbitration. In such cases this could provide the necessary protection for the taxpayer.

Inclusion of Suppliers

The provisions in the Bill do not apply to the delivery of goods, supplies or equipment under a construction contract. Various suppliers' organisations would like to extend the scope of the Bill to include contracts for the supply of all construction materials/supplies/ equipment or alternatively supplies that have been made for a specific construction project (bespoke supplies).

Supply transactions that take place as part of a construction project are already legislated for by the European Communities (Late Payment in Commercial Transactions) Regulations 2002 (S.I. No. 388 of 2002) referred to in Option 1. Whilst it is appreciated that these regulations are most effective when the payment is not disputed, the issue of late payment is not confined to the construction sector and is therefore more suited to legislation covering all commercial transactions. This legislation will be subject to review following the passing of an EU Directive[12] on the matter earlier this year. This review is the responsibility of the Department of Enterprise, Jobs and Innovation.

However, there is a reasonable case for including some provision for supplies that have been made for a specific construction project (i.e. bespoke supplies). However, the technical process of amending the legislation to include such supplies could prove complex and may even give rise to further disputes.

[12] Directive 2011/7/EU of the European Parliament and of the Council - 16 February 2011 - on combating late payment in commercial transactions (recast)

Other Issues

The purpose of the Bill is specific in that it is to regulate payments in the construction sector and address the issue of non-payment. The consultation raised the issue of **broadening the Bill to apply to all disputes**. However, there was not consensus amongst the stakeholders who attended the consultation on this issue. The following table based on UK data shows the primary subject of adjudications in the UK.

Primary subjects of the disputes[13]

Subject	2004	2005	2007	2008
Valuation of Final Account	12%	14%	22%	22%
Failure to comply with Payment Provisions	19%	14%	8%	19%
Valuation of interim payments	15%	3%	15%	16%
Withholding monies	10%	11%	10%	10%
Extension of Time	8%	8%	8%	9%
Loss and Expense	9%	10%	2%	7%
Valuation of Variations	15%	17%	11%	5%
Defective Work	4%	5%	7%	4%
Determination	2%	3%	4%	4%
Non-payment of fees	2%	1%	7%	2%

It is apparent that that 'Final account' features prominently over the years covered by the report and has grown over the years to be the most common subject of dispute but that might simply be because the vast majority of adjudication referrals are initiated after practical completion and at that stage of projects any dispute is likely to impact in some way on the Final Account. However, it is also apparent that the vast majority of disputes relate to payment and broadening the scope of the legislation to include all forms of dispute would therefore seem unwarranted at this point.

Public Works Contracts (receivership / examinership issues)

The issue arose of **whether the State could make direct payments to sub-contractors under public works contracts who are not paid by the main contractor when in receivership / examinership**. In such cases the provisions of company law apply, regardless of whether it is a public or private contract, for example:

[13] Adjudication Reporting Centre – Report 10 June 2010

- If a State body has paid money that it owes to a main contractor, and the firm then goes into receivership or examinership, then that money comes under the control of the receiver or examiner. Company law prescribes how he may use that money; for example, in relation to amounts due to employees or the Revenue Commissioners.

- If a main contractor goes into receivership or examinership before a State body has fully paid for work done then, in simple terms, company law dictates that the debt is still due. However, the debt is payable to the receiver or examiner, and can be pursued by him. The debt involved would be needed by him so that he, in turn, may fulfil his payment obligation under the Company law.

- For as long as the State is obliged to pay the receiver or examiner for any amounts the State owes to a main contractor then any other action could have adverse consequences for the taxpayer. For example, any proposal in such circumstances for the State to make direct payment to subcontractors or others would expose the taxpayer to the risk of having to pay twice for work done. Obviously it would not be appropriate to open the taxpayer to the risk of having to pay twice.

The State cannot override these concerns and must ultimately retain the right to protect the taxpayer. It must also be borne in mind that current procurement rules require that the financial robustness of construction companies must be assessed by public bodies at the initial selection stage of the procurement process before the tenders of those companies are evaluated. This policy is set out in the Government's Capital Works Management Framework[14] (CWMF). Department of Finance Circular 6/10[15]makes it mandatory for contracting authorities to comply with all aspects of CWMF.

[14] The CWMF is a detailed framework of guidance documents, formal contracts, procedures and standard templates to assist contracting authorities in the development and delivery of public works projects from inception to completion.

[15] http://www.constructionprocurement.gov.ie/CWMFDocs/Circulars/Circ0610.pdf

Section 4: Consultation

The Construction Contracts Bill 2010 was introduced in the Seanad as a Private Members Bill by Senator Feargal Quinn on 19 May 2010 and passed Committee and remaining stages in the Seanad on 8 March 2011. It is now before the Dáil.

The Programme for Government also contains a commitment to introduce new legislation to protect small building subcontractors that have been denied payments from bigger companies. In this regard, Minister of State Mr Brian Hayes TD met with Senator Feargal Quinn in order to continue the collaborative approach taken by the previous Government to advance the Construction Contracts Bill. As a number of concerns were raised in context of the Seanad Debate on the Bill, they agreed that it was important to take into account the approach taken to similar legislation in other jurisdictions which included consultations between Government Departments and the relevant industry and professional bodies, to explore ways of addressing this issue without placing unnecessary regulatory or cash-flow problems on the industry.

In addition, the Department of Public Expenditure and Reform has received a number of submissions on the Bill from bodies representing the construction sector. Whilst there has been widespread expression of support in principle for the Bill, concerns have been expressed about the robustness of the legislation passed by the Seanad, particularly in relation to the scope of the Bill and the non-binding nature of the adjudication process.

Minister of State Mr Brian Hayes TD and Senator Feargal Quinn arranged for a meeting on 28th June to discuss the Bill and the issue of non-payment in the sector with the relevant stakeholders and opposition spokespersons. The main participants and representative bodies that attended the consultation were:

- Minister of State Brian Hayes TD
- Senator Feargal Quinn
- Seán Fleming TD (Fianna Fáil spokesperson on Public Sector Reform)
- Mary Lou McDonald TD (Sinn Féin Deputy Leader)
- Construction Industry Federation;
- Royal Institute of the Architects of Ireland;
- Society of Chartered Surveyors Ireland;
- Association of Consulting Engineers of Ireland;
- Engineers Ireland
- Chartered Institute of Arbitrators
- Irish Concrete Federation

Senator Quinn set out the four main objectives concerning payment that he wanted to achieve in bringing the legislation forward. These were:

- *Timing* – when will (sub-contractor) be paid?
- *Amount* – How much will sub-contractor be paid?
- *Enforcement* – Ability to enforce sub-contractor to be paid
- Ensure that there's enough cash to pay (*Security* of Payment)

Minister of State Mr Brian Hayes TD thanked the Senator for the hard work and commitment he has shown in bringing the Bill to this stage. He reiterated the Governments commitment to addressing this issue in a meaningful way and stressed the importance of finding a solution to the problem of non-payment in the construction sector that does not place an unnecessary regulatory or cost burden on the parties to the dispute, other parties involved in the project, or the State.

There was broad agreement from all participants with the principles for improving the current payment dispute procedures and with the main objectives of the Bill. The consultation highlighted a variety of views with differing levels of consensus on common themes. The main issues raised at the meeting and in correspondence received in relation to the Bill were:

- **Exclusion of smaller contracts from the scope of the Bill.** Under the amendments passed by the Seanad, private contracts below €200,000 and public contracts below €50,000 do not come within the scope of the Bill.

  There is agreement amongst the construction sector representative bodies that such thresholds should be removed from the Bill.

- **Non-binding status of adjudication award while under appeal.** The Bill as amended provides that an adjudication award is binding, except where either party refers the case to arbitration or to the courts.

In general, this amendment is perceived as a means by which payment of an award can be avoided. Whilst it was appreciated that this could present a problem in the case of larger public sector contracts, the strong consensus of the construction sector was that the legislation should be amended to allow for binding adjudication.

- **Suppliers.** The provisions of the Bill do not extend to suppliers of materials except in the case of a contract that includes the installation of the supply.

  Various suppliers' organisations would like the scope of the Bill extended to cover contracts either bespoke supplies made specifically under a given contract or to cover all supplies of construction materials/supplies/equipment.

  Whilst is was appreciated that the problem of non-payment of suppliers, particularly in the current economic climate, was not unique to the construction sector, the inability, in certain circumstances, of the supplier to retrieve goods supplied as part of a construction contract was put forward as being unique.

- **Security of payment.** Some construction sector bodies have sought to have security provisions included in the legislation. These security arrangements would cover sub-contractors in the event of non-payment under a construction contract. However, precise proposals on the nature and cost of such arrangements are not clear. It was argued that whilst the problem of non-payment is common in the sector, the cost of providing some form of security for payments under a construction contract would not be costly.

In addition to the above points, some participants raised the issue of whether the right to suspend work under a contract should be confined to 14 days and whether the scope of the Bill should be extended to cover all forms of dispute not just those relating to payment.

The consultation process also examined a number of technical matters that related to the legal interpretation of certain provisions of the Bill. As these issues do not form part of this RIA it was proposed that legal advice will be sought on such technical matters.

Minister of State Brian Hayes TD brought the consultation to a close by thanking all for the contributions that had been made and by stating that the above issues will be examined in the RIA which will be published in advance of the Bill going before the Dáil early in the next session.

Section 5: Enforcement and Compliance

The objective of the legislation is to reduce the sub-contractor's exposure to the risk of non-payment. The legislation seeks to achieve this through two elements:

Firstly, the legislation provides that contracts must include minimum arrangements for interim payment over the period of the contract. The parties to the contract may agree between themselves an interim payment arrangement, otherwise, the default arrangement set out in the legislation arrangement will be deemed to apply. The purpose of this provision is to ensure that the issue is addressed by the parties at the outset. In this way, parties should not unwittingly get themselves into situations where they are fully exposed to non-payment of a large bill built up over the course of the contract.

The second element, adjudication, including the selection of a panel of adjudicators and the possible preparation and publication of a code of practice for adjudication is the responsibility of the Minister for Public Expenditure and Reform. All adjudicators, whether selected from the panel or agreed independently between parties to the contract, must comply with the code of practice governing the conduct of adjudicators.

The issue of whether there is a potential conflict of interest in that the Minister selects the chair of the panel of adjudicators, as well as being an interested party in public works projects, was raised during consultation. However, as the chair will be independent in their duties which would include selection of adjudicators, it was felt that no conflict arose.

Section 6: Review

There is no provision for review in the legislation. However, given the absence of data on this issue, it is likely that such a review would be worthwhile. The Section or Ministerial Order dealing with the review should also provide for the collection, analysis and publication of data similar to the position in the UK as highlighted in this RIA. [The data

gathered as well as the Adjudicator's decisions, and relevant papers, should be collected by the secretariat to the Adjudication board.]

Section 7: Publication

The RIA will be published on the Department's website: www.per.gov.ie