EXPLANATORY MEMORANDUM TO

THE CONSTRUCTION CONTRACTS (ENGLAND) EXCLUSION ORDER 2011

2011 NO. 2332

1. This explanatory memorandum has been prepared by the Department for Business, Innovation and Skills and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

Primary legislation, Part 2 of the Housing Grants, Construction and Regeneration Act 1996 ("the 1996 Act"), provides that construction contracts must comply with various requirements. This instrument excludes a type of construction contract –a "first tier pfi sub-contract" – from a specific requirement of Part 2 of the 1996 Act. A first tier pfi sub-contract is a contract between the non-public body party (the Special Purpose Company or "SPC") to a pfi agreement and a third party (essentially the main construction contractor) in which the former sub-contracts construction obligations in the pfi agreement to the latter.

3. Matters of special interest to the Joint Committee on Statutory Instruments

This instrument will be made using the power at new section 106A(1) of the 1996 Act – the first such use of this power by the Secretary of State. Section 106A takes the place of a power which only permitted construction contracts to be excluded from *all* of the requirements of Part 2 – the new power allows any or all of the requirements at Part 2 to be disapplied.

4. Legislative Context

4.1 Part 2 of the 1996 Act was amended by Part 8 of the Local Democracy, Economic Development and Construction Act 2009 ("the 2009 Act"). With the exception of the power to make this instrument (which power has already been commenced), Part 8 of the 2009 Act will be commenced on 1 October 2011. Upon the commencement of Part 8, "first tier pfi sub-contracts" would otherwise be caught by all of the new construction contract requirements provided for by Part 8 and it is for this reason that this "excluding" instrument is being made. The effect of this Order will be to allow payments in "first tier pfi sub-contracts" to be conditional on obligations being performed in other contracts.

4.2 A related instrument – which is being laid at the same time – is the Scheme for Construction Contracts (England and Wales) Regulations 1998 (Amendment) (England) Regulations 2011.

4.3 Pfi agreements (as opposed to the sub-contracts which are the subject of this instrument) are themselves already excluded from all of Part 2 of the 1996 Act – see Article 4 of the Construction Contracts (England and Wales) Exclusion Order 1998.

5. Territorial Extent and Application

5.1 This instrument applies to England.

5.2 Separate, similar, instruments are being made by the Devolved Administrations in Scotland and Wales.

6. European Convention on Human Rights

The Minister of State for Business and Enterprise has made the following statement regarding Human Rights:

In my view the provisions of the named Statutory Instrument are compatible with the Convention rights.

7. Policy background

- What is being done and why

7.1 The 1996 Act has always prevented the use of "pay when paid" clauses in construction contracts i.e. clauses whereby B will not pay C unless B has himself been paid by A. The 1996 Act prevents these clauses because this was a commonly used contractual mechanism to delay payment to the supply-chain. Some firms in the industry have, however, avoided the effect of this by making payment dependent on the issue of a certificate (e.g. a valuation of the work by A's agent) under the superior contract. The 2009 Act closes this loophole by preventing any term in a construction contract which makes payment conditional on the performance of an obligation under another contract – see new section 110(1A) of the 1996 Act

7.2 New section 110(1A) will adversely affect pfi projects to an unwarranted degree and it is for this reason that this "excluding" instrument is being made. In most pfi arrangements the main construction contractor will have a shareholding in the SPC and is therefore a direct beneficiary of measures which reduce the need to capitalise the SPC. In addition, where the main construction contractor is not an SPC shareholder, it will (unlike traditional construction contracts) have full knowledge of the pfi agreement and the terms of the funding - this will be provided for by standard terms in the first tier pfi sub-contract. This means that the main construction contractor will already have priced the non-payment risk.

7.3 Note that this instrument only excludes the operation of new section 110(1A) as regards first tier pfi sub-contracts. All of the other requirements of Part 2 of the 1996 Act

(such as the right of parties to a construction contract to refer a dispute to "adjudication" or to suspend performance if payments are not made) will apply to these contracts.

8. Consultation outcome

The Government has not formally consulted in connection with this instrument. It did, however, consult extensively in connection with the provisions which now form Part 8 of the 2009 Act and in connection with the instrument referred to in paragraph 4.2 above. The consultation in connection with Part 8 revealed that pfi contracts would be disproportionately affected by new section 110(1A) and discussions were subsequently held with interested parties – the PPP Forum and Infrastructure UK in HM Treasury. The Government considered that a formal, public consultation was unnecessary – this is a technical instrument and those interested or affected by it are few in number.

9. Guidance

No guidance or similar material is being provided.

10. Impact

10.1 The impact on business, charities or voluntary bodies can be more readily ascertained from the accompanying Impact Assessment.

10.2 An Impact Assessment is attached to this memorandum and will be published alongside the Explanatory Memorandum on www.legislation.gov.uk.

11. Regulating small business

11.1 The legislation applies to small businesses – it applies to construction businesses of all sizes within the construction supply-chain.

11.2 Taken together with the instrument referred to at paragraph 4.2 and the amendments made by Part 8 of the 2009 Act, this instrument is de-regulatory and we have therefore secured a waiver from the micro-business exemption introduced in the 2011 Budget.

12. Monitoring & review

Infrastructure UK in HM Treasury and the PPP Forum referred to above will alert us to any issues as regards the operation of this instrument.

13. Contact

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