EXPLANATORY MEMORANDUM TO

THE CONSTRUCTION CONTRACTS (ENGLAND) EXCLUSION ORDER 2022

2022 No. 839

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Business, Energy and Industrial Strategy and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument excludes two types of construction contract from the provisions of the Housing Grants, Construction and Regeneration Act 1996 ("the Act"):

- Direct Procurement for Customers (DPC) Competitively Appointed Provider (CAP) Contracts - excluded from all requirements of Part 2 of the 1996 Act; and
- Direct Procurement for Customers (DPC) First Tier Sub-Contracts - excluded from section 110(1A) of the 1996 Act.

2.2 Both contract types (defined in sub-section 7.6) form part of a new procurement model, known as Direct Procurement for Customers (DPC) for the finance, design, building, operation and maintenance of high value water and sewerage infrastructure.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is England and Wales.

4.2 The territorial application of this instrument is England.

5. European Convention on Human Rights

5.1 Lee Rowley MP, Parliamentary Under Secretary of State at the Department for Business, Energy and Industrial Strategy for has made the following statement regarding Human Rights:

"In my view the provisions of the Construction Contracts (England) Exclusion Order 2022 are compatible with the Convention rights."

6. Legislative Context

6.1 Three pieces of construction payment and dispute resolution legislation work together to create a statutory framework for construction contracts in England:

- Part 2 of the Housing Grants, Construction and Regeneration Act 1996. Amended by Part 8 of the Local Democracy, Economic Development and Construction Act 2009. Part 2 provides a framework for fair and prompt payment through the construction supply chain, and a resolution procedure for

disputes by providing a statutory right to adjudication. Provisions of the Act include:

- the right to be paid in interim, periodic or stage payments;
- the right to be informed of the amount due, or any amounts to be withheld;
- the right to suspend performance for non-payment;
- the right to adjudication; and
- disallowing pay when paid clauses.

- The Scheme for Construction Contracts (England and Wales) Regulations 1998. Amended by the Scheme for Construction Contracts (England and Wales) Regulations 1998 (Amendment) (England) Regulations 2011. Part 1 of the Scheme makes provision for adjudication where the contract does not comply with the Act. Part 2 of the Scheme replaces those provisions in relation to payment that do not comply with the Act.
- The Construction Contracts (England and Wales) Exclusion Order 1998 and the Construction Contracts (England) Exclusion Order 2011. Provides for the exclusion of specific construction contracts from all, or part of, Part 2 of the Act for Private Finance Initiative (PFI) Agreements.

6.2 Where a construction contract omits to deal with an issue or does so in a way which does not meet the requirements of the Act, the Scheme for Construction Contracts ("the Scheme") is deemed to apply in the contract.

6.3 Due to the contracting and financing approach of the DPC procurement model, the payment provisions under the Act have implications for the structure and operation of the contracts. This instrument excludes two types of construction contract for the DPC procurement model in the regulated water and sewerage sector.

6.4 PFI agreements and PFI First Tier Sub-Contracts are already excluded from all of Part 2 of the 1996 Act and section 110(1A) under the 1998 and 2011 Exclusion Orders.

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 closed this loophole by preventing any term in a construction contract which makes payment conditional on the performance of an obligation under another contract – section 110(1A) of the 1996 Act.

7.2 Due to the financing arrangements of DPC, payment to the firm that has delivered the infrastructure by the commissioning water and sewerage firm is through a unitary charge, which only commences once at least one sewerage or water asset has been completed and is capable of operating. However, the CAP agreement and first tier sub-contracts fall under the definition of a construction contract and therefore may be subject to challenge for non-compliance with the Act. If non-compliant, the relevant payment provisions of the Scheme for Construction Contracts are implied in the contract and will take precedence over contract provisions designed for DPC. This

would adversely affect the structure and operation of these project agreements, and make these less attractive to investors, and it is for this reason that this "excluding" instrument is being made.

7.3 The instrument is limited to a specific procurement model for high value infrastructure assets in the regulated water and sewerage sector. These will be procurements undertaken by private companies. Public interest in the Exclusion Order is expected to be minimal. There are two projects under active development and a further 18 strategic water resource schemes are being progressed which may meet DPC eligibility criteria across the next 2-3 price review periods.

7.4 This instrument excludes two types of construction contract from the Housing Grants, Construction and Regeneration Act 1996 ("the Act"):

- Direct Procurement for Customers (DPC) Competitively Appointed Provider (CAP) Contracts - excluded from all requirements of Part 2 of the 1996 Act; and
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7.5 All remaining construction contracts through the supply chain (in particular for SMEs) would remain subject to all the provisions of the Act.

7.6 A DPC CAP contract is a contract between a water company appointed by Ofwat and a CAP, a limited company successful in a competitive procurement process. The CAP is likely to be Special Purpose Vehicle, owned by a private consortium likely to include a construction company, funder and service provider. A DPC First Tier Sub-Contract is a contract between the CAP to a DPC agreement and a third party (the main construction contractor) in which the former sub-contracts construction obligations in the DPC agreement to the latter.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

9.1 There are no plans to consolidate these regulations.

10. Consultation outcome

10.1 The instrument is limited to a specific procurement model in the water and sewerage regulated sector (sewerage or water undertaker appointed under section 6(1) of the Water Industry Act 1991) with private companies.

10.2 The exclusion is technical and narrow in scope and impacts on a small segment of the construction sector and other stakeholders. A targeted consultation, through individual and group meetings, with relevant construction industry and water sector stakeholders was undertaken over a two-month period.

10.3 For each Devolved Administration construction is a devolved matter. Engagement at Ministerial and official level has been undertaken on the proposed instrument and highlighted where Administrations may wish to consider corresponding legislative changes. Each Administration welcomed engagement and noted this Order. Wales will consider whether similar legislation might be required.

11. Guidance

11.1 Guidance is not required.

12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies.

12.2 There is no, or no significant, impact on the public sector.

12.3 A full Impact Assessment has not been prepared for this instrument because it will only affect a limited number of businesses and the impact is estimated to be less than £5m per year. Ofwat has undertaken a full impact assessment of DPC.

13. Regulating small business

13.1 The legislation does not apply to activities that are undertaken by small businesses.

14. Monitoring & review

14.1 The approach to monitoring of this legislation is via Ofwat, with notification of any issues as regards to the operation of this instrument.

14.2 The instrument does not include a statutory review clause. In line with the requirements of the Small Business, Enterprise and Employment Act 2015, Lee Rowley MP, Parliamentary Under Secretary of State at the Department for Business, Energy and Industrial Strategy has made the following statement:

"The business impacts for this instrument falls significantly below the £5m threshold, at an estimated £54k. Given the limited and specific scope of this measure to the water sector, and in particular large water infrastructure projects, a statutory review is not deemed to be required. Furthermore, given the significant time period each DPC contract will run for, policy certainty is required in this area and the exclusion could not be revoked halfway through a contract".

15. Contact

15.1 James Brown-Humes at the Department for Business, Energy and Industrial Strategy Telephone: 020 7215 6278 or email: James.BrownHumes@beis.gov.uk can be contacted with any queries regarding the instrument.

15.2 Fergus Harradence, Deputy Director for Infrastructure and Construction, at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.

15.3 Lee Rowley MP, Parliamentary Under Secretary of State at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.