EXPLANATORY MEMORANDUM TO

The Construction Contracts Exclusion Order (Northern Ireland) 2012

2012 No. 366

1. Introduction

1.1. This Explanatory Memorandum has been prepared by the Department of Finance and Personnel to accompany the Statutory Rule (details above) which is laid before the Northern Ireland Assembly.

1.2. The Statutory Rule is made under Article 5(1A) of the Construction Contracts (Northern Ireland) Order 1997 and is subject to the Assembly affirmative resolution procedure.

2. Purpose

2.1. Primary legislation, the Construction Contracts (Northern Ireland) Order1997 ("the 1997 Order") as amended by the Construction Contracts (Amendment) Act (Northern Ireland) 2011 ("the 2011 Act"), provides that construction contracts must comply with various requirements. This Rule excludes a type of construction contract –a "first-tier private finance initiative (PFI) sub-contract" – from a specific requirement of the 1997 Order. A first-tier PFI subcontract 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.

2.2. New Article 5(1A) of the 1997 Order takes the place of a power which only permitted construction contracts to be excluded from all of the requirements of the Order – the new power allows any or all of the requirements of the Order to be disapplied.

3. Background

3.1. Upon the commencement of the 2011 Act, "first-tier PFI sub-contracts" would otherwise be caught by all of the new construction contract requirements provided for by the 2011 Act and it is for this reason that this "excluding" Rule 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.

3.2. PFI agreements (as opposed to the sub-contracts which are the subject of this Rule) are themselves already excluded from all of the 1997 Order – see article 3 of the Construction Contracts Exclusion (Northern Ireland) Order 1999.

3.3. A related Rule – which is being laid at the same time – is the Scheme for Construction Contracts in Northern Ireland (Amendment) Regulations (Northern Ireland) 2012 ("the Scheme").

3.4. The 1997 Order 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 1997 Order prevents these clauses because this was a commonly used contractual mechanism to delay payment to the supply-chain. However, consultation with the construction industry in GB suggests that some firms 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 2011 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 Article 9(1A) of the 1997 Order.

3.5. New Article 9(1A) may, however, adversely affect PFI projects to an unwarranted degree requiring this "excluding" Rule. In most PFI arrangements the main construction contractor will have a shareholding in the special purpose company (SPC) set up as the non-public party to the agreement and will therefore become 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 subcontract. This means that the main construction contractor will already have had the opportunity to have priced the non-payment risk.

3.6. Note that this Rule only excludes the operation of new Article 9(1A) as regards first-tier PFI sub-contracts. All of the other requirements of the 1997 Order (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.

4. Consultation

4.1. The Department has not formally consulted in connection with this Rule. It has relied, however, on the extensive Department for Business, Innovation and Skills consultations and discussion with the industry in GB in connection with the provisions in the corresponding GB legislative measures which are now closely replicated in the 2011 Act and in connection with the Scheme for Construction Contracts in Northern Ireland (Amendment) Regulations (Northern Ireland) 2012. The consultations in GB in connection with the corresponding GB legislation revealed that PFI contracts would be disproportionately affected by the GB equivalent to the new Article 9(1A) and discussions were subsequently held in GB with interested parties – the PPP Forum and Infrastructure UK in HM Treasury. As in GB, the Department considered that a further formal, public consultation was therefore unnecessary – this is a technical Rule and those interested or affected by it are few in number.

5. Equality Impact

5.1. Compliance with section 75 of the NI Act 1998 was assessed at the primary legislation stage and found to be compatible.

6. Regulatory Impact

6.1. A separate regulatory impact assessment has not been carried out in respect of the proposed regulations as these issues were addressed at the primary legislation stage.

7. Financial Implications

7.1. There are no financial implications.

8. Section 24 of the Northern Ireland Act 1998

8.1. As this Statutory Rule is technical, and is unrelated to Community Law, there are no section 24 implications.

9. EU Implications

9.1. Not applicable.

10. Parity or Replicatory Measure

10.1. This Rule closely replicates recent amendments to corresponding legislation in England, Wales and Scotland. The public consultations carried out to amend the primary legislation (the Order) and the subordinate legislation (the Scheme) heavily endorsed the policy to maintain parity with the legislative position throughout the UK in order to provide a level commercial playing field and allow a common basis for the emergence of legal precedent.

11. Additional Information

11.1. Not applicable.