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Regulating Commercial Contracts: What can we Learn from Part II of the Housing Grants, Construction and Regeneration Act 1996?

Charlotte Ellis*

I. Introduction

The scholarship of commercial contracts in the twenty-first century has a blind spot. Few today would deny Macneil's argument that contracts are socially embedded, and that co-operative and trusting relationships are essential to successful commercial activity.[1] The findings of ground-breaking empirical work by Stuart Macaulay in the US,[2] replicated by and Beale and Dugdale in England and Wales,[3] have been similarly absorbed. It is taken for granted by contract scholars that trusting and co-operative commercial relationships can and do flourish without direct recourse to the legal system, because non-legal sanctions and the parties' mutual self-interest in the continued relationship will generally do the work. But underlying the reception of these insights is an unwarranted assumption that inequality of bargaining power in commercial contexts, if it exists at all, is rarely a barrier to the creation of trust and co-operation.

The fact that inequalities of power do exist in commercial contexts, and their very real capacity to obstruct the creation of trust and co-operation if not regulated, is a blind spot in current contract scholarship. Statutes which perform this regulatory role, such as Pt II of the Housing Grants, Construction and Regeneration Act 1996 (HGCRA), are overlooked, and their implications are not explored. We focus on socio-legal studies of markets where inequalities of power are regulated by non-legal forces or institutions.[4] Empirical work on markets where powerful actors are *not* constrained in

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[1] See generally ZX Tan, 'Disrupting doctrine? Revisiting the doctrinal impact of relational contract theory' (2019) 39 *Legal Studies* 98. Of course, the legal relevance of these insights remains contested.

[2] S Macaulay, 'Non-Contractual Relations in Business: A Preliminary Study' (1963) 28 *American Sociological Review* 55.

[3] H Beale and T Dugdale, 'Contracts Between Businessmen: Planning and the Use of Contractual Remedies' (1975) 2 *British Journal of Law and Society* 45.

[4] The markets considered in the studies listed in nn 2 and 3 above share this feature, as do the markets considered in Lisa Bernstein's influential work on private legal systems.

this way, raising the important question of law's role in this very different situation, has not received the attention it deserves.[5]

This chapter seeks to bring these matters into our field of vision, and to consider their implications. It argues that importance of contract law in supporting commerce by promoting trust and co-operation, and the ways in which it does so, varies significantly according to the context in which a commercial relationship is embedded. Law can in principle perform two key functions in this regard: it can provide sanctions for breach of contract, and it can regulate inequality by curbing the ability of powerful actors to use their advantage in ways which are likely to undermine trust and co-operation. In some contexts, both of these functions may be performed entirely by non-legal forces or institutions. In others, legal sanctions and regulation play a background role. But where a market contains significant inequalities of power which are not regulated by non-legal means, law can and does operate *in the foreground*: its sanctions and regulation can be a crucial factor in facilitating trust and co-operation.

Contract scholars should not ignore or marginalise the markets where law performs these regulatory tasks. Nor should we assume that the regulation of inequality in commercial relationships is unnecessary. And we should not assume that law is incapable of providing such regulation where non-legal forces or institutions do not. Instead, we should consider the dynamics of this form of legal regulation, and the ways in which its inherent challenges can be and have been met.

The chapter proceeds as follows. Section II identifies the blind spot in contract scholarship, showing how leading theories fail to address the regulation of inequality in commercial contracting. Section III sets out the argument that the importance and role of law in supporting trust and co-operation in commercial relationships varies with context. It is argued that contract law should be viewed as just one element of the *contractual environment* within which individual commercial relationships occur. Existing empirical work is used to demonstrate the importance of sanctions and the regulation of inequality in promoting trust and co-operation in commercial markets, whether provided by legal or non-legal techniques. A key element in the contractual environment is the presence, or absence, of *system trust* – a level of trust among market participants which is generated by normative structures operating in the market as a whole, as distinct from the trust created by the parties to particular transactions or relationships. Evidence is highlighted which shows that the non-legal institutions which generate system trust in other jurisdictions tend to be weaker in England and Wales, with the result that legal sanctions and regulation assume a greater role.

Section IV demonstrates the importance of legal sanctions and regulation in supporting trust and co-operation by looking in depth at the case of construction contracts, which in the UK are regulated by the HGCRA. This interventionist statute, which receives little attention in work on commercial contracts, can be seen as a direct response to a crisis of trust and co-operation in the UK construction industry. The reports which preceded its enactment paint a striking picture of a commercial market where the absence of effective legal or non-legal sanctions for breach of contract, combined with a lack of effective regulation of inequalities between different market actors, undermined system trust. This challenging contractual environment, and in

[5] See section III below.

particular the lack of constraints on the ability of powerful commercial actors to use their advantage in damaging ways, meant that the parties to individual transactions struggled to create even basic levels of trust and co-operation. Unable to resolve these problems for themselves, construction industry bodies looked to the Government to help them identify and implement effective solutions to the lack of trust in their market. This resulted in a joint government–industry review of contracting and procurement arrangements in the construction industry, known as the Latham Review.

Section V considers the role of legislative reform of contract law in the package of recommendations arising from the Latham Review. The primary recommendation was that the industry should move away from the somewhat classical and adversarial approach to contracting found in its most commonly used standard forms of contract, in favour of the more relational approach found in the (then) recently introduced New Engineering Contract (NEC), which emphasised and incentivised co-operation, planning and the sharing of risk. But, recognising the inherent limitations of the standard forms as a means of regulation, it was also recommended that a legislative underpinning should be given to two elements of the NEC's approach which were considered key to the creation of trust and co-operation. The legislative underpinning would ensure that these elements could not be removed by parties exercising their freedom of contract under the general law.

The two elements so identified demonstrate the potential importance of legal sanctions and the legal regulation of inequality in facilitating trust and co-operation in commercial relationships in this context. The first concerned sanctions. The Latham Review recommended that construction contracts should be legally required to contain terms which provided for adjudication – a quick, cost-effective form of ADR which resulted in a legally enforceable sanction for breach of contract. It was also recommended that the payment procedures in construction contracts should be legally required to contain certain features which would ensure adjudication operated effectively in payment disputes. The second element regulated inequality more directly. The Review recommended that 'pay-when-paid clauses', a widely used payment arrangement under which the right to payment was made conditional on the paying party's receipt of funds from a third party, should be rendered legally invalid. This would remove the ability of more powerful parties to impose these onerous terms on weaker parties. The HGCRA substantially adopted these recommendations, despite their significant interference with freedom of contract.

Section VI considers the question of how the kind of regulation found in the HGCRA, and the ways in which it seeks to overcome the inherent challenges of regulating commercial activity, can be theorised. Discussions of these difficulties in contract scholarship tend to focus on *substantive* or *command and control* regulatory approaches, overlooking Teubner's more promising concept of *reflexive law.*[6] The HGCRA could be seen as an example of reflexive law. However, Teubner's concept does not capture two important features which are key to its regulatory strategy. The first is the close involvement of construction industry and client bodies in the process which led to the HGCRA's enactment and in determining its contents. The second is the way in which, as a result of gaps which were consciously left in the statute, the courts were

[6] G Teubner, 'Substantive and Reflexive Elements in Modern Law' (1983) 17 *Law and Society Review* 239.

required to complete its regulatory scheme by devising the new legal rules and principles which would govern adjudication enforcement. In the light of these features, it is argued that the HGCRA can be better understood using a new concept: *responsive reflexivity*.

II. A Blind Spot in Contract Scholarship

The blind spot in contract scholarship arises in part from a common starting point that, although the function of commercial contract law is to support the market, its role in doing so is in practice somewhat secondary or indirect. For example, David Campbell characterises contract law as playing an important background role in supporting commercial relations. Campbell highlights the ways in which the legal rules on remedies for breach of contract incentivise co-operative behaviour following a breach of contract, [7] and shows how other rules of contract law can undermine co-operation by providing the occasion for opportunism. [8]

Campbell argues that aspects of the rules of classical contract law are unsuited to the needs of more complex, relational contracts but emphasises the need for competent commercial parties to use appropriate drafting techniques to mitigate these problems,[9] citing Macneil's comprehensive guide, 'A Primer of Contract Planning'.[10] For Macneil, however, sophisticated drafting was only part of the story. He acknowledged that legislative intervention might also be needed to support the robust operation of the common contract norms in particular spheres of activity, especially those involving more complex, relational contracts and / or imbalances of power.[11] This form of 'relational contract law',[12] of which the HGCRA is an example, receives little attention in discussions of commercial contract law. Its operation goes beyond the background role which Campbell identifies.

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[7] D Campbell, 'The Relational Constitution of Remedy: Co-operation as the Implicit Second Principle of Remedies for Breach of Contract' (2005) 11 *Texas Wesleyan Law Review* 455.

[8] D Campbell, 'Arcos v Ronaasen as a relational contract' in D Campbell, L Mulcahy and S Wheeler (eds), *Changing Concepts of Contract: Essays in Honour of Ian Macneil* (Basingstoke, Palgrave Macmillan, 2013).

[9] D Campbell, 'What Do We Mean by the Non-Use of Contract' in J Braucher, J Kidwell and W C Whitford (eds), *Revisiting the Contracts Scholarship of Stewart Macaulay* (Oxford, Hart Publishing, 2013) 171–73.

[10] IR Macneil, 'A Primer of Contract Planning' (1974–1975) 48 *Southern California Law Review* 627.

[11] See I Macneil, 'Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical and Relational Contract Law' (1977–1978) 72 *Northwestern University Law Review* 854, 881–83 and IR Macneil, 'Relational Contract Theory: Challenges and Queries' (2000) 94 *Northwestern University Law Review* 877, 893 and 899. Macneil was clear that whether such support *should* be extended, as opposed to simply leaving the relationship to degenerate, was a separate question.

[12] Macneil, 'Challenges and Queries' (ibid) 897–99.

A more circumscribed account of law's role in supporting commercial markets is found in Hugh Collins' *Regulating Contracts.*[13] Collins' starting point is that the constitution of markets requires the presence of trust, effective sanctions against disappointment and betrayal, or a combination of these two factors.[14] Drawing on empirical studies by Macaulay and others, Collins argues that the role of contract law in creating these conditions is minimal. Trust arises primarily from prior dealings between the parties or from ties of kinship or ethnicity, which have nothing to do with law. Non-legal sanctions such as loss of future business, supplemented by security sanctions such as the taking of a deposit, provide the main incentive against betrayal or disappointment. The possibility of seeking enforcement of a contractual obligation or compensation for breach through the courts plays a very minor role. Collins suggests that the parties will only concern themselves with the question of whether their agreement is legally enforceable if trust is absent and there are no clear incentives, such as non-legal sanctions, to fulfil the expectations under the transaction.[15] The implication seems to be that such situations are very rare.

Collins accepts that the legal rights and obligations contained in the contract play a background role during the course of a contractual relationship even though, for the most part, the parties will act according to the different norms and understandings found in their business relationship and the economic deal which underpins it.[16] In principle, then, the terms of the contract might usefully be the subject of regulation designed to enhance trust and therefore efficiency.[17] But he sees only a limited role for such regulation in commercial contexts. The possibility that legislative intervention might be needed to qualify or redistribute power in order to enhance trust in commercial relationships is considered as part of a wider discussion of how the law should respond to contracts which appear on their face to create a relationship of power and dominance.[18] Two categories of commercial contract are identified as potential candidates for such regulation: *symbiotic contracts* (such as contracts of agency or franchise) [19] and *hybrid* or *multi-party organisation contracts* (such as the contracts which govern relationship between a trade union and its members, or the supra-contractual governance structures which, on Collins' account, govern relations between the numerous individual firms involved in a large building project).[20] But Collins' suggestions are tentative, and in the case of hybrid contracts he emphasises the need to preserve the balance of interests set by the parties' own self-regulation.[21] Collins does not consider the possibility that this balance of interests might itself need to be regulated to ensure it is set in a way that promotes, rather than undermines, trust and

[13] H Collins, *Regulating Contracts* (Oxford, Oxford University Press, 1999).

[14] ibid ch 5.

[15] ibid 123.

[16] ibid.

[17] ibid 241, 252.

[18] ibid ch 10.

[19] ibid 239–46.

[20] ibid 246–54.

[21] ibid 252.

co-operation. Existing legal regulation which seeks to do this, such as the HGCRA, is not brought into the discussion.

In *Contract Law Minimalism*,[22] Jonathan Morgan argues that law's role in the commercial sphere is even more limited. Morgan shares Collins' starting point that the function of commercial contract law is to provide a workable framework for business transactions, [23] and his acceptance that such a framework should support trust and co-operation in the relationships within which transactions are embedded.[24] However, where Collins perceives a background role for the parties' contractual rights and obligations throughout their relationship,[25] Morgan argues that law only becomes relevant when their relationship has irretrievably broken down and they seek resolution of their dispute through litigation. Before this point, commercial relationships 'broadly look after themselves (being backed by social norms and the promise of mutual gain from on-going co-operation)'.[26] The idea that commercial parties will successfully create and maintain co-operative and trusting relationships if left to their own devices is a key strand in Morgan's argument that the content of commercial contract law should be minimal. The possibility that, where inequality is present, they might need greater regulatory assistance from the law appears to be ruled out.[27] Empirical evidence which shows this can be the case, and legislation such as the HGCRA, which responds to the need for greater regulation in this situation, is not considered.

III. Re-framing the Inquiry

One explanation for the failure of contract scholarship to explore more fully the regulation of inequality in commercial contracts is that the leading theoretical accounts, and much of the empirical work on which they are based, are legal-centric inquiries. They start with law, asking what role it plays in supporting trust and co-operation in commercial relationships. A different picture is revealed if we start with the phenomenon of trust itself, asking the broader question of how trust and co-operation are generated in commercial relationships. Approached in this way, empirical studies by Macaulay,[28] Lisa Bernstein[29] and others, which are often taken to show the limited role

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[22] J Morgan, *Contract Law Minimalism – A Formalist Restatement of Commercial Contract Law* (Cambridge, Cambridge University Press, 2013).

[23] ibid 89.

[24] ibid 123.

[25] Collins, *Regulating Contracts* (1999) ch 3.

[26] Morgan, *Contract Law Minimalism* (2013) 99.

[27] See, for example, ibid 109: '[A]llowing the failure of sub-rational businesses will have a positive effect on overall market efficiency in a kind of "creative destruction" or Darwinian survival of the fittest. Intervention can always be based on the economic pretext of "market failure". But effective laws against fraud and monopoly should ensure a basically level playing field.'

[28] Macaulay, 'Non-Contractual Relations in Business' (1963).

[29] L Bernstein, 'Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms and Institutions' (2001) 99 *Michigan Law Review* 1724; L Bernstein, 'Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms' (1996) 144

of law, appear in a new light. What they suggest is that sanctions and the regulation of inequality can be crucial to the creation of trust. They provide evidence that markets exist where the necessary sanctions and regulation are provided by non-legal forces or institutions. But this evidence does not, in itself, answer the question of how law should respond when such non-legal regulation is absent.

A more fruitful way of approaching *this* question, consistently with the insights of relational contract theory, is to view contract law as just one part of the broader context in which any given commercial relationship occurs. This approach was taken in a body of work arising from a major interdisciplinary study of commercial relationships between manufacturers and suppliers in Britain, Germany and Italy, which will be referred to here as 'the Cambridge Study'.[30] Rather than seeking to investigate the influence of law specifically, the Cambridge Study asked the more open question of how trust between firms was generated.[31] The researchers, drawn from the fields of economics, management and business, organisational science and sociology as well as law, gathered a comprehensive set of contextual empirical data on two sample industries, kitchen furniture manufacturing and mining machinery manufacturing, and examined it from a range of perspectives. By using a comparative methodology they were able to explore more fully the ways in which law can contribute to the construction of trust. Their findings demonstrate the importance of sanctions and external constraints on the ability of powerful firms to fully exploit their advantage in facilitating the creation of trust and co-operation. They also suggest that although such sanctions and constraints can be created by non-legal institutions and frameworks, law can play an important role in contexts where such non-legal structures are lacking.

A. System Trust and the Contractual Environment

The work arising from the Cambridge Study used two key concepts in examining the link between trust in commercial relationships and their broader context, which enabled them to consider this link in greater depth. The first is *the contractual environment*, which captures 'the social, institutional and organisational context' within which individual contracts in a given market are embedded.[32] It includes

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University of Pennsylvania Law Review 1765; L Bernstein, 'The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study' (1999) 66 *University of Chicago Law Review* 710; and L Bernstein, 'Opting out of the Legal System:Extralegal Contractual Relations in the Diamond Industry' (1992) 21 *Journal of Legal Studies* 115.

[30] The full title of this project was the UK ESRC Contracts and Competition Programme (award number L114251016, 'Vertical Contracts, Incentives and Competition'). Details of the project can be found in S Deakin and J Michie, 'Contracts and competition: an introduction' (1997) 21 *Cambridge Journal of Economics* 121.

[31] ibid. The particular focus was on close, inter-firm co-operation between manufacturers and suppliers in vertical supply chains.

[32] A Arrighetti, R Bachmann and S Deakin, 'Contract law, social norms and inter-firm co-operation' (1997) 21 *Cambridge Journal of Economics* 171. See also B Burchell and F Wilkinson, 'Trust, business relationships and the contractual environment' (1997) 21 *Cambridge Journal of Economics* 217, 221.

> the broad normative framework of laws, customs and assumptions within which inter-firm relations are embedded … as well as other factors which might affect the form and content of contracts such as the available state of know-how, technology and the structure of the markets concerned. [33]

The second key concept is *system trust*. This is a level of trust between participants in a market which is generated by normative structures operating within the market itself.[34] These normative structures might be formal and institutional (eg the rules of a trade association, the rules of contract law) or informal and social (eg a stable norm of commercially acceptable behaviour in a given field of commerce).[35]

B. System Trust and Non-legal Regulation

The potential impact of system trust on overall levels of trust and co-operation in a commercial market is demonstrated by the striking contrast between Britain and Germany, which is identified in the outputs arising from the Cambridge Study. In Germany the researchers found high levels of system trust, combined with high levels of trust in individual commercial relationships, close forms of inter-firm co-operation and low levels of conflict. Litigation to enforce contractual obligations was extremely rare.[36] In Britain, by contrast, very little system trust was found in the two sample industries. The lack of system trust, and the resulting pressure on the parties to individual transactions to create trust for themselves, meant that co-operation between firms took more limited forms, and levels of conflict and resort to litigation were much higher.[37]

The primary factor in creating system trust in Germany was identified as the existence of a stable framework of legal and extra-legal norms whose contents were well known and taken for granted by both suppliers and manufacturers as standards of appropriate commercial behaviour.[38] Legal norms formed part of this normative framework: German firms entered formal, comprehensive contracts and their employees had a clear understanding of their legal obligations and of what the outcome

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[33] ibid 176.

[34] ibid 175–76.

[35] ibid.

[36] ibid 187–88.

[37] ibid 187–89, 191.

[38] S Deakin and F Wilkinson, 'Contract Law and the Economics of Interorganizational Trust' in C Lane and R Bachmann (eds), *Trust Within and Between Organisations: Conceptual Issues and Empirical Applications* (Oxford, Oxford University Press, 1998) 157.

of litigation might be.[39] But extra-legal norms and institutions, in particular those generated and enforced by trade associations, were equally important.[40]

A second factor identified as promoting trust and co-operation in the German sample industries was the *content* of this stable framework of norms and standards. Many of the norms, particularly those created and enforced by trade associations, operated to curb the ability of more powerful firms to fully exploit their advantage where this would be damaging to other firms, or to the interests of the industry as a whole.[41] For example, trade bodies in both industries produced General Conditions of Business which, whilst formally optional, were in very wide use.[42] The existence of these General Conditions of Business, and their contents, provided an effective means of protection for smaller supplier firms against larger buyer firms who might otherwise seek to impose more onerous terms when negotiating contracts.[43] Similarly, trade associations used competition rules and recommendations to define and publicise acceptable market behaviour, and to stigmatise transgressions which might harm other participants in the market.[44] And finally, many of the norms in this framework, including legal norms, expressed or presupposed values of co-operation and mutuality as opposed to the untrammelled pursuit of individual self-interest. This may also have had some impact on the ability of powerful actors to pursue their self-interest in harmful ways. [45]

Payment terms provide a good example of these techniques in action. In Germany, payment periods in both industries were set at 30 days by trade association recommendations, and so in practice did not become a battleground in contractual negotiations at the level of individual transactions. The reputational damage which would result from a failure to pay on time, together with a practice of offering a modest discount for timely payment, ensured that prompt payment was the norm and resort to legal or non-legal enforcement mechanisms was extremely rare.[46]

Overall, a picture emerges of a contractual environment in Germany in which commercial activity was highly regulated, albeit by a combination of mutually supportive legal and non-legal techniques. The parties to individual contracts had less work to do in creating trust, because in important areas such as payment and quality, trust had been created for them at the system level by the stable and 'taken-for-granted'

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[39] S Deakin, C Lane and F Wilkinson, 'Contract Law, Trust Relations and Incentives for Co-operation:A Comparative Study' in S Deakin and J Mitchie (eds), *Contracts, Co-operation and Conpetition: Studies in Economics, Management and Law* (Oxford, Oxford University Press, 1997) 131.

[40] See generally C Lane, 'The social regulation of inter-firm relations in Britain and Germany: market rules, legal norms and technical standards' (1997) 21 *Cambridge Journal of Economics* 197.

[41] C Lane and R Bachmann, 'Co-operation in inter-firm relations in Britain and Germany: the role of social institutions' (1997) 48 *British Journal of Sociology* 226, 239–40.

[42] Deakin, Lane and Wilkinson, 'Contract Law, Trust Relations' (1997) 112.

[43] ibid.

[44] Lane and Bachmann, 'Co-operation in inter-firm relations in Britain and Germany' (1997) 240.

[45] Arrighetti, Bachmann and Deakin, 'Contract law' (1997) 178.

[46] Lane and Bachmann (n 41) 240.

framework of legal and extra-legal norms of acceptable commercial behaviour. But the creation of trust in individual transactions was also assisted by the various ways in which this normative framework regulated inequalities of power between commercial actors.

C. The Role of Law where Non-legal Regulation is Weak

The picture of the contractual environment in Britain revealed in the Cambridge Study provided a stark contrast to the findings in relation to Germany. The researchers found no equivalent of Germany's stable system of legal and extra-legal norms. This was linked to the absence, in the British contractual environment, of strong trade associations. German trade associations, which were 'powerful forces in German industry and society',[47] could set and enforce norms of market behaviour for entire industries. By contrast, most British trade associations were a 'negligible force'[48] and could not perform this function. Against this background, the commonly expressed view among English interviewees that personal relationships were the key to creating trust[49] was only part of the story. The evidence suggested that the availability of effective legal sanctions for breach of contract was also important.[50] The legal system can perhaps be seen as providing an essential if minimum level of system trust. Across both industries studied, British firms were significantly less certain about the likely outcomes of litigation than their German counterparts, but much more likely to take legal action against a contracting partner, particularly for breach of a payment obligation.[51] Late or non-payment of commercial debts was identified as a pervasive problem in the UK, and the primary response to this problem was litigation.

A further consequence of the lack of strong trade associations in the British contractual environment was that any regulation of contract terms in the industries studied, and in particular any curbs on the ability of powerful firms to exploit their advantage in damaging ways when negotiating contracts, had to come from elsewhere. The British kitchen furniture industry, where dealings between manufacturers and suppliers involved relatively simple or 'discrete' contracts for the sale of generic screws and hinges, had no history of standard form contracts or other kinds of self-regulation, but exhibited no obvious problems arising from inequalities of market power. But matters were different in the mining machinery sector, where contracts between manufacturers and subcontractors or suppliers were more complex and involved the supply of made-to-order components. Deakin et al noted that although collectively agreed standard form contracts did exist in the British mining manufacturing industry, their use was in decline. Some buyers in the newly privatised industries had abandoned the industry standard forms, preferring to impose harsh new terms on manufacturers. This had in turn caused manufacturers to pressurise their subcontractors, leading to

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[47] Deakin, Lane and Wilkinson (n 39) 114.

[48] ibid 115.

[49] Burchell and Wilkinson, 'Trust' (1997) 226.

[50] Arrighetti, Bachmann and Deakin (n 32) 187–88.

[51] ibid.

negative effects on trust and co-operation throughout the supply chain.[52] English contract law, with its emphasis on autonomy and freedom of contract, offered nothing to fill this regulatory gap.

The work arising from the Cambridge Study directs our attention to the important question of how the law should support commercial relationships in contexts where effective non-legal sanctions and regulation are lacking. Existing contract scholarship has not adequately addressed this question. But it can be addressed by studying particular contract types which have their own regime of legal regulation. By asking why and how such regulation came into being, how it operates in practice, and how it seeks to overcome the inherent challenges of regulating commercial activity, we can build a more complete picture of the relationship between law and contracting practice.

The remainder of this chapter begins the task by examining the HGCRA, a highly interventionist statute which regulates construction contracts for work carried out in England, Wales or Scotland.[53] The origins of this statute in the Latham Review are considered, together with the Review's findings. These findings reveal the UK construction market in the 1990s as a commercial context in which sanctions and regulation of inequality were needed to facilitate the creation of trust and co-operation, but were not being provided by either legal or non-legal means. Unable to resolve these problems for themselves, construction industry bodies actively sought government assistance in both identifying and implementing regulatory solutions through the vehicle of the Latham Review. The legislative proposals arising from the Review, and in particular those which were ultimately enacted in the HGCRA, provide an example of the ways in which legislative intervention in particular contract types can provide the regulation and sanctions which are needed to support trusting and co-operative relationships.

IV. 'Trust and Money' – The Origins of the HGCRA

A. The Latham Review

The Latham Review was announced by the Government in July 1993 as an initiative aimed at improving relationships in the construction industry. The objective would be to identify practical reforms which would 'reduce conflict and litigation and … encourage productivity and competitiveness'.[54] The review was jointly funded by the Government and organisations representing the different parts of the construction industry ('the four

[52] ibid 191.

[53] Pursuant to s 104(7), the HGCRA applies irrespective of whether the contract itself is governed by English or Scottish law. The meaning of 'construction contract' is carefully defined in ss 104–05 and particular subsectors of the construction industry, such as process plant engineering, are expressly excluded. Pursuant to s 106, the Act does not apply to contracts with a residential occupier, effectively excluding consumers from its scope of operation. As originally enacted, the HGCRA applied only to contracts in writing pursuant to s 107. However, this section was repealed by the Local Democracy, Economic Development and Construction Act 2009.

[54] *Hansard* HC Written Answers Vol 228, cols 4–5 (5 July 1993).

funding bodies'): the Construction Industry Council (CIC), representing professional consultants such as architects, engineers and surveyors; the Construction Industry Employers' Council (CIEC) representing main contracting firms; the National Specialist Contractors Council (NSCC), representing specialist and trade subcontractors, and the Specialist Engineering Contractors Group (SECG) representing specialist engineering subcontractors. It can be seen at once why this industry might struggle to regulate its own affairs without assistance. The different categories of firm involved in the construction process each had their own trade association and there was no overarching body which could provide a forum for co-ordinated action or the balancing of competing interests.[55]

The origins of the Review are described in Adams and Pollington, *Change In the Construction Industry – Account of the UK Construction Industry Reform Movement 1993–1996*.[56] Several government reviews of the construction industry had taken place during the post-war period.[57] But in contrast to these earlier exercises, the impetus for the Latham Review came from within the construction industry itself. Adams and Pollington describe a growing realisation in the late 1980s among industry bodies that fundamental change was needed to deal with major shortcomings in both the industry's relationship with the Government (its biggest client) and its internal structure and relationships. These bodies initiated discussions with senior political figures with a view to obtaining government support for a major review of the problems, and perhaps government leadership of the required changes.[58]

In 1992 the Government acceded to the growing industry demands and began to take active steps to prepare for a major review of the construction industry.[59] But from the outset this was conceived as an industry-led project, with the Government playing a co-ordinating and facilitative role. Ministers and civil servants took active steps to encourage all sections of the industry to participate in the review, and to focus on their objectives for the industry as a whole, rather than on their narrow sectoral interests.[60]

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[55] The four funding bodies and their composition are set out in Sir Michael Latham, 'Trust and Money – The Interim Report of the Joint Governmental Industry Review of Procurement and Contractual Arrangements in the UK Construction Industry' (London, HMSO, 1993) 37. The complexity in fact went further: the four funding bodies were 'umbrella bodies' composed of numerous smaller organisations representing subgroups within the same general category whose members may have had competing interests and priorities.

[56] DM Adamson and T Pollington, *Change in the Construction Industry: An account of the UK Construction Industry Reform Movement 1993–2003* (Abingdon, Routledge, 2006). This book, whose authors were involved in some of these events as a construction industry client representative and a civil servant respectively, sets out to provide 'a dependable and authoritative record of what went on' during the Latham Review and the following decade using a combination of interviews and the examination of key documents.

[57] These included E Simon, 'Report of the Central Council for Works and Buildings chaired by Sir Ernest Simon' (London, HMSO, 1944); HC Emmerson, 'Survey of Problems before the Construction Industries' (London, HMSO, 1962) and Sir H Banwell, *The Placing and Management of Contracts for Building and Civil Engineering Work* (London, HMSO, 1964).

[58] Adamson and Pollington, *Change in the Construction Industry* (2006) 8–10.

[59] ibid 11.

[60] ibid 11–14.

They also ensured that the review took a format which commanded industry support, and that the reviewer was an independent figure who was acceptable to all industry sectors, and to its clients.[61] Sir Michael Latham, a recently retired MP, was ultimately chosen.

The terms of reference for the review, which were agreed after lengthy negotiations between representatives of the four funding bodies, effectively asked for an inquiry into the contractual environment in which the construction industry operated. But the objective was clearly focused on the need to improve trust and co-operation, together with productivity and competitiveness.[62]

The Latham Review was not a social scientific inquiry in the nature of the Cambridge Study, but its interim report, 'Trust and Money'[63] and final report, 'Constructing the Team',[64] provide a wealth of evidence of the state of the UK construction industry and the context in which it operated in the early 1990s, which can be cross-referenced with other sources.[65] Latham worked with a team of assessors drawn from the four funding bodies and from two further bodies representing the construction industry's clients.[66] Over the course of the 12-month review he held 140 formal meetings and interviews with interested parties from the industry and its clients, together with a small number of MPs and lawyers, supplemented by many further informal contacts by telephone and at industry functions.[67] He also received letters from 100 MPs on behalf of construction firms in their constituencies, and a large number of direct responses, following the publication of 'Trust and Money' in December 1993.[68]

Read in conjunction with contemporaneous sources, the two reports present a picture of a highly dysfunctional market with a pervasive lack of trust among participants.[69] Two particular features stand out. The first is the lack of effective sanctions for breach of contract (whether legal or non-legal). The second is the absence of controls on the ability of parties at all levels of the industry to use whatever power

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[61] ibid 19, noting that some in the industry were adamant that, unlike earlier government reviews, the Latham Review should be the work of a single reviewer and should have government backing without government control.

[62] The Terms of Reference are set out in Latham, 'Trust and Money' (1993) 30.

[63] ibid.

[64] Sir M Latham, 'Constructing the Team – Final Report of the Government / Industry Review of Procurement Arrangements in the UK Industry' (London, HMSO, 1994).

[65] In particular, Latham's findings are consistent with the findings of a contemporaneous socio-legal study, J Flood and A Caiger, 'Lawyers and Arbitration: the Juridification of Construction Disputes' (1993) 56 *Modern Law Review* 412.

[66] These were the Chartered Institute of Purchase and Supply (CIPS) and the British Property Federation (BPF).

[67] The formal meetings are listed in Latham, 'Constructing the Team' (1994) 116–19.

[68] ibid 2.

[69] The title of Latham's interim report was inspired by the words of an experienced subcontractor who told him 'there is no trust in this industry any more' – see Latham (n 55) 10–11.

they had against weaker parties, and to act in ways which were damaging to the interests of the industry as a whole as well as those of its clients.

B. Self-regulation through Standard Form Contracts

Construction contracts are often referred to in general work on contract law in ways which overlook the dire straits in which the industry found itself at the time of the Latham Review, and the importance (or even the existence) of the legislative regulation which now underpins their operation. In particular, the longstanding existence of standard form contracts and subcontracts produced by industry bodies such as the Joint Contracts Tribunal (JCT) and Institute of Civil Engineers (ICE) is sometimes taken to indicate that the construction industry is largely self-regulating.

These standard forms, drafted by bodies containing representatives from all sides of the industry, attempt to strike a fair balance of risk and interest between the different participants in a construction contract. In principle, therefore, they are a means of regulating inequality and a potential source of system trust. But in practice they have inherent limits as a form of regulation, particularly as compared to the General Conditions of Business found in Germany, which were considered in the Cambridge Study.[70] Their primary limitation is that the legal and non-legal structures which ensure the wide use of the General Conditions of Business in Germany have no equivalent in the English contractual environment. As at 1993–94, Latham found that the standard forms were rarely used in an un-amended state,[71] and were frequently rejected by larger firms who adopted their own standard terms and conditions of contract or subcontract, or clients who preferred a bespoke contract. [72]

A second limitation is that the ability of the standard forms to meet the demands of the industry, particularly during times of change and in challenging market conditions, depends on the effectiveness of the drafting bodies and their internal structures and organisation. The Latham Review found that, as at 1993–94, the drafting bodies and the documentation which they had produced left much to be desired. They had been unable to produce standard forms of subcontract which were acceptable to both main contractors and subcontractors, leaving this important and contentious category of relationships outside of the industry's regulatory mechanism.[73] And they had not produced the more complex suites of contract documents which were needed to cope with a major change in the structure of the industry which had occurred over the preceding 30 years and intensified during the 1990–92 recession, namely, the vast increase in the proportion of on-site work which was carried out by subcontractors as opposed to workers employed directly by the main contractor.[74] In many cases the

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[70] See section III above.

[71] Latham (n 64) 35.

[72] Latham (n 55) 26–27.

[73] ibid 26. The JCT and ICE had responded to the impasse by publishing subcontract documentation which was not approved by groups representing subcontractors, causing widespread dissatisfaction.

[74] ibid 8.

terms of the now numerous subcontracts on a construction project did not match the procedures and risk allocations assumed by the main contract, and contained important gaps, which in turn led to 'confusion of responsibility, transfer of risk, adversarial attitudes and litigation'.[75]

These and other findings by the Latham Review suggest that the supra-contractual governance structures identified by Collins as essential to the success of a modern construction project had not emerged as at 1993–94.[76] Instead, construction projects were characterised by routinely dysfunctional relationships between the participants, whilst confidence in the traditional governance structures found in the standard forms had been undermined.

C. Relationships between Main Contractors and Subcontractors

Given the fragmented structure of the construction industry, subcontracting relationships were of particular importance for the success of a building project. The Latham Review found that, following financial pressures caused by the 1990–92 recession, relationships between main contractors and subcontractors had substantially deteriorated. A major factor in this deterioration was the lack of effective legal or non-legal sanctions available to subcontractors faced with breach of a payment obligation. Main contractors freely admitted during the Review that they had ensured financial survival in a difficult economic climate by engaging in 'controversial dealings' with subcontractors such as paying them late; making an 'early payment' discount to payments under the subcontract even when this had not been allowed for in the contract or where payment was made late instead of early; and disingenuously engaging them in prolonged arguments about the sums properly due for variations to the subcontract works.[77] Flood and Caiger's contemporaneous socio-legal study confirms that these practices were widespread, and points to a further form of 'subbie bashing', namely the practice of cynically delaying payment until the subcontractor was forced into bankruptcy, meaning in practice that its payment claim would no longer be pursued.[78] Non-legal sanctions such as reputational damage appear to have been ineffective to deter these practices, and prevailing industry norms may even have encouraged them.[79]

In this situation one might expect that, as with the British industries considered in the Cambridge Study, legal sanctions would assume greater importance. But in the construction context, the legal process was a much less effective way of dealing with non-payment. The factual complexity of construction disputes meant that even in the specialist Official Referees' courts, trials were long and expensive. The quicker and

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[75] ibid.

[76] Collins (n 13) 250–51.

[77] Latham (n 55) 21.

[78] Flood and Caiger, 'Lawyers and Arbitration' (1993) 422.

[79] The Review quotes a survey carried out on behalf of a main contracting firm which attributed problems to 'the industry "macho" culture, where we reward crisis management and "screw the subbie"': Latham (n 64) 82.

cheaper summary judgment procedure was of little practical use to a subcontractor seeking to enforce its right to payment.[80] The subcontractor's straightforward claim in debt could easily be met by a defence of set-off based on allegations of delay or defects which were unsuitable for determination under this procedure, so that a full trial would be ordered, even though the allegations might be somewhat disingenuous.[81] Arbitration was similarly unsatisfactory.[82] Many subcontractors were small or even one-person firms,[83] and in the absence of an effective legal or non-legal sanction to enforce their rights to payment, large numbers of them became insolvent.[84]

This can be seen as a situation in which procedural law, rather than the substantive law of contract itself, was unsuited to the needs of construction contracts. The consequences were significant: even the minimum level of system trust which is normally provided by the availability of legal sanctions was lacking in relations between main contractors and subcontractors. Main contractors acknowledged that the general atmosphere of distrust caused by the prevalence of abusive payment practices was having a negative impact on the performance of subcontractors.[85] As subcontractors were now carrying out the majority of the work on site, this had in turn affected the quality of the service which main contractors were able to provide to their clients.[86] But main contractors had been unable, collectively or individually, to resolve these problems.

In addition to the need for effective sanctions, the Review found that a lack of more general regulation of the inequality between main contractors and subcontractors was contributing to the distrust and resentment. Fragmentation of the industry, combined with significant excess capacity and low entry barriers at all levels, had greatly increased the bargaining power of main contractors when negotiating subcontracts. In addition to the payment abuses referred to above, main contractors were able to impose onerous terms on their subcontractors including terms which cut down their rights to payment in the first place.[87] A particular source of antagonism was 'pay-when-paid' clauses, which made the obligation to pay the subcontractor contingent on the paying party's receipt of funds from the client or another third party. This made it

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[80] RSC Ord 14, now replaced by CPR 25, provided for the summary disposal of claims without the need for a full trial where the responding party had no real prospect of success.

[81] For an account of the way in which 'rather thin' cross-claims could be used to defeat applications for summary judgment under Ord 14, see P Coulson, *Construction Adjudication*, 3rd edn (Oxford, Oxford University Press, 2015) 4. Lord Coulson, who before his elevation to the bench practised in the Official Referees' Courts and their successor, the Technology and Construction Court, suggests this unsatisfactory state of affairs, and the rejection of Lord Denning's common law solution to it by the House of Lords in *Modern Engineering Ltd v Gilbert-Ash* [1974] AC 689 (HL), can be seen as 'the genesis of compulsory adjudication'.

[82] Latham (n 55) 31–32. See also Flood and Caiger (n 65) 88.

[83] Latham (n 64) 7.

[84] ibid 9.

[85] ibid 82.

[86] ibid.

[87] Latham (n 55) 26–27.

difficult for the subcontractor to know whether and if so when its right to payment had accrued, undermining its ability to assert or enforce its payment rights and hindering financial planning. It also placed the risk of wrongful non-payment by the client, or client insolvency, on the subcontractor. Given the long chains of subcontracts and sub-subcontracts which now existed on large construction projects, pay-when-paid clauses were a significant source distrust and instability.

D. Relations between Clients and Main Contractors

Although the construction industry has a longstanding adversarial culture, it seems likely that the heightened difficulties identified above were caused by the reaction of main contractors to the 1990–92 recession, which had resulted in 'substantial excess capacity and too many firms chasing too little work'.[88] Main contractors began to compete aggressively on price, and a 'low bid, high claim' culture developed in which tenders were routinely submitted at unrealistically low sums, on the basis that some flaw in the drawings or specification had been identified which could in due course be used to claim additional monies under terms in the standard forms which were designed to provide flexibility in unforeseen circumstances.[89] If the strategy failed, the main contractor would make a loss on the project, in which case there was a significant risk of its becoming insolvent. If it succeeded, the cost to of the project would increase significantly from the original tender. Unsurprisingly, the increased risks of main contractor insolvency and unexpected cost increases led to distrust and dissatisfaction on the part of clients.[90]

Clients were also justifiably concerned about quality.[91] The practice of under-bidding and dysfunctional relations with subcontractors seem likely to have contributed to these problems. However, in line with the findings of the Cambridge Study, the Review identified a piecemeal and tentative approach to the regulation of quality in construction through the use of voluntaristic quality management *processes*, rather than the technical *standards* found in countries such as Germany. Latham expressed doubt as to whether the recently introduced quality assurance system would have an impact on site activities,[92] and noted that the absence of any entry barriers to becoming a main contracting firm in terms of training, accreditation or capital had led to the presence of incompetent firms whose existence posed a threat to responsible firms even if market forces would, in the end, drive them out of business.[93] This can be seen as another example of the UK construction market's lack of non-legal mechanisms creating system trust, so that the burden of creating trust in relation to quality fell entirely on the arrangements within individual contracts.

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[88] ibid 13. See also Flood and Caiger (n 65) 419.

[89] Latham (n 55) 15 and 20. The operation of these clauses is explained more fully below.

[90] Latham (n 64) 11–12.

[91] ibid 78.

[92] ibid 79–80.

[93] ibid 66.

At the level of individual contracts, the Review found that clients were using their superior bargaining power to impose onerous contract terms on main contractors in the hope of gaining greater protection against these risks. To reduce the prospect of cost increases, the standard forms were rejected in favour of a bespoke contract, or amended to alter the balance of risk in the client's favour.[94] Insolvency risk was countered by extending the payment periods set by the standard forms, and by requiring main contractors to provide performance bonds, often in an 'on demand' format, which imposed a significant burden on their finances.[95] Following the decision in *Murphy v Brentwood District Council*,[96] which effectively removed clients' ability to sue in negligence in respect of latent defects, it became common to require broad collateral warranties from numerous participants in a construction project, some of which were impossible to insure and would be likely to result in insolvency if enforcement was sought.[97] Subcontractors in particular complained that they were being required to assume responsibility for work over which they had no practical control.[98] Litigation over latent defects was complex and costly: the fragmented nature of the construction process meant that defects were often the result of complex combinations of acts or omissions by numerous different firms and individuals, so that trials would involve difficult technical issues, expert evidence and multiple parties.[99]

E. Governance Structures and the Role of Construction Professionals

A third factor identified in the Latham Review as undermining trust and co-operation was that the governance structure relied on in traditional construction contracts, including the standard forms, was proving inadequate in a changed contractual environment. In a traditional construction contract, the client obtains a complete design for the works from a design professional which is then executed by the main contractor under the supervision of an architect or engineer who is engaged by the client to act as the contract administrator.[100] The contract administrator plays a crucial role in the operation of a number of clauses which are used in the standard forms to provide the flexibility needed in a complex, long-term construction project. In carrying out this role, he or she owes a professional duty to act impartially as between the client and the main contractor, despite having been engaged by the client and acting for many other purposes as the client's agent.

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[94] Latham (n 55) 12 and 23–24.

[95] ibid 12 and 24. Latham records that the amount of a performance bond was counted directly against the contractor's overdraft facility, thus increasing levels of financial strain and perhaps the risk of insolvency.

[96] *Murphy v Brentwood District Council* [1991] 1 AC 398.

[97] Latham (n 55) 12, 24 and (n 64) 99.

[98] See Department of the Environment, 'Latent Defects Liability and 'BUILD' Insurance – A consultation paper issued by the Department of the Environment' (1995) 5.

[99] Latham (n 64) 100.

[100] S Furst and V Ramsay, *Keating on Construction Contracts*, 10th edn (London, Sweet & Maxwell 2016) 5.

The prime example of these sophisticated and important clauses is a variations clause, which provides that additional work not shown in the contract drawings or specification may be instructed, valued and paid for during the course of the project under a contractual procedure. Typically, variations clauses also have the effect that practical difficulties or restrictions on site, or discrepancies in the drawings or specification, which would otherwise place the client in breach of contract, are instead identified and compensated for as variations.[101] The existence or otherwise of a true variation, and the payment which is properly due if a variation does exist, are determined by the contract administrator acting as a neutral arbiter between the interests of the client and the main contractor. Other examples are 'extension of time' and 'loss and expense' clauses, which allocate the risk of particular events which might delay the agreed completion date or increase costs in an unanticipated way. These clauses again set out procedures under which the causes of delay and the contractor's entitlement to additional time for completion and / or reimbursement of additional costs are determined by the contract administrator acting impartially.[102]

Given the 'low bid, high claim' culture and the general atmosphere of distrust noted above, the proper operation of these clauses assumed a critical importance. However, the Latham Review found that changes in the way architects and engineers were selected and paid, and pressure from clients to ensure that the costs of a project did not increase beyond expectations, had led them to approach their duties in a more defensive and adversarial way. This had called into question their ability to achieve the impartiality and even-handedness envisaged by the standard forms.[103] It was also noted that contract administration on many projects was now carried out by a project manager who might not be subject to the same professional or legal duties as an architect or engineer in any event.[104] Although the standard forms allowed a contract administrator's decision to be challenged by arbitration or litigation, both were slow and expensive[105] and could often be pursued only at the end of the construction project. Main contractors and subcontractors argued that a further tier of governance structure was needed so that decisions and certificates issued by contract administrators could be

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[101] See, for example, clause 13 of the JCT Standard Form of Building Contract 1980, which was current at the time of the Latham Review. This can be found in Joint Contracts Tribunal, 'JCT Guide to the Standard Forms of Building Contract 1980 Edition' (London, RIBA Publications Limited, 1980) 93–95. The equivalent provision in the current edition, the JCT Standard Building Contract 2016, is clause 5.

[102] See for example, clauses 25 and 26 of the JCT Standard Form of Building Contract 1980, which can be found in 'JCT Guide' (ibid) 102–06. The equivalent provisions in the JCT Standard Building Contract 2016 are clauses 2.26–2.29 and 4.20–4.24.

[103] Latham (n 55) 18.

[104] ibid 7. See also the comments of a senior construction solicitor writing some four years later: 'The traditional model of construction and engineering contracts being administered by 'impartial' professionals who, while being paid fees by the owner, are obliged by professional and legal rules to administer the contracts in an even-handed manner free from client pressure, is plainly no longer the case'. T Blackler, 'Statutory Adjudication under the HGCR Act – Some Difficulties' in J Uff (ed), *Construction Contract Reform: A plea for sanity* (London, Construction Law Press, 1997).

[105] See Flood and Caiger (n 65), 432, noting that construction arbitration could involve heavy delays, and would typically involve costs exceeding those of litigation.

reviewed by an independent third party during the course of the works.[106] But although support was growing across the industry and its clients for the introduction of a speedy, independent dispute resolution procedure which could be used during the course of a construction project, architects in particular opposed it, and no concrete action had been taken to introduce such a mechanism into the main standard forms.[107]

These findings in the Latham Review support the argument that both the availability of sanctions and the regulation of inequality are important in facilitating the creation of trusting and co-operative relationships, whether provided by legal or non-legal means. They also provide a concrete example of a context in which commercial actors and trade bodies were unable to create the regulation and sanctions which were needed to support their activities, and where the failure of the legal system to fill this gap led to a collapse of trust and co-operation. The Review's recommendations, discussed below, show how the reform of contract law as it relates to specific contract types can provide a way to address such difficulties.

V. 'Constructing the Team' – Recommendations and Implementation

The final report of the Latham Review, 'Constructing the Team', was published in July 1994. The recommendations it contained were not the product of negotiation and compromise between the industry and client bodies who had participated in the review. Instead, 'Constructing the Team' was presented as 'the personal Report of an independent, but friendly, observer' [108] who had sought to produce 'a balanced package'[109] of recommendations which he hoped they would adopt. Many of the recommendations had nothing directly to do with law. However, legislation was proposed in two key areas. First, Latham advised that a 'legislative underpinning' was needed to support a wider reform of the industry's approach to contract drafting which was, in his view, the key to improving trust and co-operation. The core of this legislative underpinning was supported by industry and client bodies and was ultimately enacted in the HGCRA. As explained below, the content of the proposals supports this chapter's argument as to the importance of sanctions and regulation of inequality in supporting trust and co-operation in commercial relations, and the ability of law to provide these things where non-legal sources do not. It is also important to note the reflexive way in which they were intended to work.

The second proposal for legal reform sought to address the lack of trust between clients and main contractors in relation to quality, and to reduce the amount of litigation generated by latent defects, using a more substantive and less flexible technique. This involved the introduction of compulsory first-party insurance against defects, and far-reaching changes to the law of limitation and joint and several liability as they applied to

[106] Latham (n 55) 18.

[107] ibid 31–32.

[108] Latham (n 64) v.

[109] ibid.

claims arising from construction projects. These proposals were not enacted: they commanded insufficient support among industry and client bodies, and faced significant opposition from the Law Commissions and other legal groups. By considering them, however, we can perhaps learn something about the limits of using legal reform to regulate commercial activity.

A. A Legislative Underpinning for the Reform of Contracting Practice

A major objective of the Latham Review had been to identify measures which would improve relationships between participants in construction projects, reducing conflict and litigation and increasing trust and co-operation. Recognising the importance of the contractual framework in the construction context, Latham's proposed solution to this problem was that the industry and its clients should rethink their approach to contract drafting and in particular move away from central elements of the traditional mode of construction contracting found in the standard forms. In itself this was a soft proposal, aimed primarily at the drafting bodies which produced the standard forms. However, given the inherent limitations of the standard forms as a means of regulation, Latham recommended that key elements of his proposed changes should be underpinned by legislation so that they could not be avoided by parties using their freedom of contract to either amend the standard form they were using, or to use their own bespoke contract.

As noted above, traditional construction contracts such as the standard forms use sophisticated drafting techniques to provide the flexibility needed in construction projects. Variations clauses, extension of time clauses and loss and expense clauses seek to manage the tension and conflict arising from the inherent uncertainty of construction operations[110] by displacing the rules of classical contract doctrine, and in particular the unrealistic assumption of complete presentiation.[111] A variations clause allows the contractually agreed scope of work or the conditions on which the contractor has access to the site to be modified after formation of the contract; an extension of time clause allows the contractually agreed completion date to be extended in the light of unforeseen circumstances; and a loss and expense clause allows the contractor to be reimbursed for unanticipated costs. However, these clauses allocate risk at the point of contract formation, and thus come as close to presentiation as possible. Extension of time clauses identify specific events which will trigger an entitlement to an extension of time for completion, placing the risk of delay caused by any other events on the contractor. Loss and expense clauses similarly tie the contractor's entitlement to reimbursement to specific events or circumstances. Variations clauses leave the risk of unanticipated costs which do not involve a departure from the original contract documents with the contractor. In a traditional building contract the conflict which ensues when the risk of unanticipated delay or cost materialises is managed by requiring the contract administrator, acting impartially, to determine how the relevant clause applies to the facts which have arisen, following a contractually mandated

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[110] See generally W Kwawu and W Hughes, 'The Impact of Relational Contracting on the Construction Industry' in F Khostrowshahi (ed), *21st Annual ARCOM Conference*, vol 2 (Salford, Association of Researchers in Construction Management, 2005).

[111] Campbell, 'What Do We Mean by the Non-Use of Contract' (2013) 171–72.

procedure. But the presence of conflict in the contractual relationship is taken for granted and perhaps even encouraged by the way in which these procedures are framed.

Latham suggested that the standard forms should be fundamentally changed so that they approximated more closely to the approach found in the (then) recently published New Engineering Contract (NEC). The NEC was drafted on behalf of the ICE by a project management consultant and seeks to operate primarily as a detailed management system for the process of completing a construction project rather than as a statement of the parties' legal rights and obligations. Its integrated suite of contract and subcontract documentation is structured so as to incentivise team work and co-operation, in particular by requiring the early identification of potential problems during the works and by adopting a starting presumption that the solution to any problems so identified will be developed in a way that brings advantages to all those affected.[112] Risks are allocated, but the aim is to channel the parties' behaviour by mandating co-operative processes in which they must agree a mutually beneficial way forward when a risk materialises. This contrasts with the processes found in traditional construction contracts which simply provide a forum within which conflict over the consequences of a risk materialising can take place. A further difference is that the NEC contract documentation prompts the parties to make their own risk allocation for the particular project, whereas the traditional standard forms contain a risk allocation set by the drafting body which is designed to remain unaltered.

Latham advised that adopting this more relational approach in the contractual documents themselves, together with an express duty 'for all parties to deal fairly with each other, and with their subcontractors, specialists and suppliers, in an atmosphere of mutual co-operation',[113] would improve trust and co-operation. But his recommendations for legal reform recognised the importance of sanctions and the regulation of inequality in making such a relational approach work.

Regarding sanctions, Latham recommended that the revised standard forms should, like the NEC, provide for the speedy determination of disputes under the main contract or any subcontracts by an impartial adjudicator[114] and should oblige the parties to comply with the adjudicator's decision immediately, albeit there would be the possibility of an appeal after practical completion of the project.[115] This was the first element of the proposed reform that Latham advised should be given a legislative underpinning. All construction contracts would be legally required to provide a right to refer disputes to adjudication.

As conceived by Latham, adjudication can be characterised as a hybrid sanction, containing both legal and non-legal elements. The adjudicator would determine the

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[112] See in particular core clause 16 of the NEC3 Engineering and Construction Contract.

[113] Latham (n 64) 37. The NEC did not contain an express duty in these terms at the time of the Latham Review, but one was quickly added in response to this suggestion.

[114] See generally ibid ch 9. Adjudication was a relatively new form of ADR at the time of the Latham Review, found in the NEC and some other standard forms but not the main standard forms produced by the ICE and JCT.

[115] ibid 88–89.

parties' *legal* rights and obligations under the contract, similarly to an arbitrator, although like an arbitrator he need not be a lawyer or follow legalistic procedures. However, Latham envisaged the courts would play an important supporting role by enforcing the adjudicator's decision, ideally using 'an expedited procedure' such as summary judgment, in any cases where the losing party refused to comply immediately.[116] The enforcement proceedings would thus take the form of an action for breach of contract in failing to implement the adjudicator's decision, but would not involve a full trial.

Latham was clear that adjudication should be available in respect of any dispute arising under a contract or subcontract, providing the additional governance structure which was needed to restore confidence in the proper operation of variations and other clauses. [117] However, adjudication's primary function would be to curb the payment abuses which he had identified as the root of the dysfunctional relationships between main contractors and subcontractors. To ensure that it would be effective in performing this task, Latham further recommended that the payment procedures in construction contracts should made more transparent, with these changes similarly underpinned by legislation. The legislation would require all construction contracts to clearly set out the period within which interim payments to all participants would fall due.[118] Construction contracts would also be required to prohibit the paying party from making a deduction or set-off against payments due under the contract without giving notice in advance, specifying the reason for the deduction and its amount.[119] This would ensure that the validity of any deduction or set-off could be made the subject of an adjudication, whilst if the paying party failed to give notice, the payment would become due in full.

The availability of a quick and effective sanction for breach of contract would itself alter the balance of power between the parties to a construction contract during the course of the works. However, Latham also recommended that pay-when-paid clauses should be removed from the standard form subcontracts, and should also be rendered legally invalid, along with cross-contractual set-off clauses.[120] These more substantive measures would regulate inequality by removing the ability of powerful parties to impose these onerous terms. But although subcontractors clearly saw these clauses as unfair, Latham's rationale for prohibiting them was not 'unfairness' in itself. It was rather the impact which such clauses had in fuelling the distrust between main contractors and subcontractors.

Latham's final recommendation for legislation to underpin the reform of construction contracts was designed to deal with the impact on trust of the high levels of insolvency in the construction industry, which combined with the long chains of contracts and subcontracts found on construction projects created a high risk that firms would not be paid for work they had carried out. The rules of property law meant that

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[116] ibid 91.

[117] ibid.

[118] ibid 37. Latham also recommended that failure to pay on time should attract a deterrent rate of interest.

[119] ibid 84.

[120] ibid 84–85.

retention of title clauses, used in other spheres of commerce to protect against this risk, were ineffective in the construction context. The materials supplied by a construction contractor become the property of the landowner once incorporated into the building. Latham noted that this issue had been addressed in North America and Germany by creating a statutory 'builder's lien' over the works, but considered that payment via a trust fund would be more effective in the English context.[121] He proposed that construction contracts should be required by law to provide for payments to the main contractor to be made via a trust fund. Changes would be made to insolvency law so that subcontractors could be paid directly from the trust fund, bypassing an insolvent main contractor's secured or unsecured creditors.[122]

The proposed legislative underpinning for Latham's otherwise soft recommendations to the industry can be seen as intended to enhance trust and co-operation within individual transactions, and to create system trust in the market as a whole. In the light of Latham's findings on the dysfunctional relationships between main contractors and subcontractors in particular, it seems likely that the co-operative attitudes he hoped to engender could only be established in individual transactions if both parties understood that the payment and other terms which they had negotiated could be legally enforced if necessary. The proposals can be seen as intended to provide a set of basic parameters within which the negotiation of individual contracts could take place. Concerns as to the transparency of payment obligations, the existence of a meaningful sanction for non-payment, and the proper operation of variations and other clauses would be resolved at the system level rather than becoming an immediate concern for parties negotiating an individual transaction.

The legislative underpinning would also regulate inequality between the parties involved in a construction project by curbing the ability of more powerful parties to act in ways which the Review had found were damaging to trust and co-operation and to the wider interests of the industry as a whole. The Cambridge Study found that German trade associations performed this function using non-legal techniques such as the formulation of General Conditions of Business and recommendations which were de facto binding on the contracting practices of whole industries. Latham was in effect proposing that, where an industry consensus existed, this function could instead be performed by legislation which modified the general law of contract.

B. Compulsory Latent Defects Insurance and Reform of the Law of Joint and Several Liability and Limitation Periods

Latham's proposed solution to the dissatisfaction surrounding latent defects was more radical, and sought to regulate inequality in more substantive and less flexible way. The root of the problem was identified as the ability of clients, who were justifiably concerned about the risk of latent defects, to use their superior bargaining power to extract extensive and often uninsurable collateral warranties from the different participants involved in delivering a construction project. As noted above, the fragmentation and complexity of the construction process meant that attempts to

[121] ibid 94.

[122] See ibid 37 and ch 10.

enforce collateral warranties often resulted in lengthy and costly multi-party litigation, and the insolvency of some defendants or potential defendants. Clients were dissatisfied, whilst those in the industry felt that the rule of joint and several liability, which enabled clients to recover the whole of their loss against any one of the parties who was legally responsible for it, irrespective of their degree of culpability as compared to the other parties involved, was unfair.

Latham's proposed solution to these issues was to remove important aspects of liability for latent defects from the bargaining process altogether. Building on the recommendations of a working party set up by the Department of the Environment (DOE) comprising client and industry representatives, Latham recommended a package of reforms which, if implemented, would have had the legal effect of removing the construction industry from the general law of joint and several liability and limitation, and the practical effect of removing the majority of disputes arising from latent defects from the private law system.

The practical removal of latent defects claims from the private law system would be achieved by introducing a legislative requirement for all new commercial, retail and industrial building projects[123] to take out compulsory first-party material damage insurance to cover the cost of rectifying latent defects for 10 years from the date of practical completion of the project.[124] The legislation would require the cost of the policy to be shared between the principal participants in the construction project (clients, professional consultants and main contractors – who may in turn pass part of the cost on to subcontractors). Importantly, from the point of view of reducing litigation, the legislation would also require the policy to exclude subrogation.

Given the ability to recover rectification costs by way of an insurance claim, it may have been expected that clients and their successors in title would be less likely in practice to pursue litigation in respect of defects.[125] However, Latham made three further recommendations which would radically change the nature of any litigation which did take place. These had been formulated, although not unanimously adopted, by the DOE working party. The first recommendation was that the legislation should be enacted to abolish joint and several liability for claims arising from construction defects, and replace it with a rule that defendants should be liable for a fair proportion of the claimant's loss, having regard to their relative degree of blame.[126] The second was that legislation should introduce a single limitation period for latent defects claims arising from new construction projects, whether arising in contract or tort, of 10 years from the date of practical completion of the project.[127] And finally, it was recommended that the client's right to recover contractual damages in respect of the cost of rectifying defects in the building should be transferred automatically to subsequent owners of the building,

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[123] The proposals envisaged that a minimum value threshold would be set, so that very small projects were not covered by the requirement – see ibid 106.

[124] Practical completion, an important milestone used in construction contracts, is certified by the contract administrator, meaning that this date would be fixed and readily identifiable.

[125] The proposals envisaged that clients would have the option of purchasing additional cover for consequential losses such as loss of rental income, or additional rental costs: Latham (n 64) 106.

[126] ibid 100. Claims for personal injury were excluded from the proposed reform.

[127] ibid 101.

including tenants with a full repairing lease.[128] The legislation would prevent parties from contracting out of these rules.

These proposals went much further than the proposed legislative underpinning for construction contracts reform. Rather than imposing procedural requirements on the private regulation created by the parties to construction projects in their contracts, they mandated specific outcomes, fixing the content of substantive private law rights and obligations. The underlying rationale of these proposals also went further than the proposals for construction contracts reform: the aim was, in part, to improve substantive fairness for its own sake, as well as to clarify the law and discourage litigation.

C. Implementation (and Non-implementation)

Part II of the HGCRA, which received Royal Assent on 24 July 1996, substantially adopted the two main elements of Latham's recommended legislative underpinning for construction contracts reform. By s 108, construction contracts relating to work to be carried out in England, Wales or Scotland[129] are required to provide a right for any party to refer disputes to an impartial adjudicator, who must decide the dispute within 28 days or such longer period as the parties may agree after the dispute has been referred.[130] The contract must further provide that the adjudicator's decision is binding until the dispute is finally determined by legal proceedings, arbitration or agreement.[131] Sections 109–10 impose procedural requirements on the payment mechanisms in a construction contract which seek to ensure that the dates on which payments fall due are clear, and that any dispute over the amount properly due will be the subject of written notices given in advance of the due date and therefore readily amenable to the adjudication process.[132] In the event that the contract does not meet the statutory requirements in relation to adjudication or payment, a set of default terms found in the Scheme for Construction Contracts (England and Wales) Regulations 1998[133] ('The Scheme') are read into the contract as necessary and take effect as implied terms. The second element of Latham's proposed legislative underpinning, which sought to regulate inequality in subcontracting relations by invalidating pay-when-paid clauses, is adopted

[128] ibid 101–02.

[129] See n 53 above for the HGCRA's precise scope of application.

[130] Pursuant to s 108(2)(d) the contract must also provide that the adjudicator may extend the period of 28 days by up to 14 days with the consent of the referring party. It must also impose a duty on the adjudicator to act impartially (s 108(2)(e)) and enable him or her to take the initiative in ascertaining the facts and the law (s 108(2)(f)).

[131] Section 108(3). The parties may agree to accept the adjudicator's decision as finally determining the dispute.

[132] The payment provisions were substantially amended by the Local Democracy, Economic Development and Construction Act 2009, but the objective remains as set out in the main text.

[133] SI 1998/648. For Scotland, see the Scheme for Construction Contracts (Scotland) Regulations 1998, SI 1998/687.

in s 113 (subject to an exception for third-party insolvency) and is supplemented by the creation of a statutory right to suspend work for non-payment in s 112.[134]

The legislative proposals in relation to payment via trust funds, and the package of proposals designed to deal with liability for latent defects, did not appear in the Bill which ultimately became the HGCRA.[135] The reason they were abandoned appears to be that, in contrast to the matters which did appear in the Bill, the necessary consensus among the industry and its clients was lacking[136] although, as explained below, they were also strongly opposed by the English and Scottish Law Commissions and other legal groups. It seems possible that their more rigid and substantive regulatory approach may have contributed to their failure to gain greater support. The proposals on latent defects in particular sought to create a modified regime of private law rights and obligations for the construction industry and to impose it in a way that left little scope for flexibility and choice at the level of individual contracts.

VI. A New Kind of Regulation

A. The Challenges of Regulating Commercial Contracts

Whilst the legislative regulation of commercial contracts by statutes such as the HGCRA has been overlooked by contract scholars, the difficulties posed by any attempt to regulate commercial activity are well recognised. Morgan, for example, characterises commercial contract law as 'radically optional',[137] pointing out that sophisticated commercial parties will seek to evade undesirable rules, and are ultimately free to opt out of the whole legal system, including its mandatory rules, using choice of law, or by exiting the legal system altogether in favour of arbitration or extra-legal enforcement.[138] Campbell draws our attention to the capacity of economic actors to respond reflexively to changes in their legal environment, adapting their behaviour in ways which are likely to frustrate any regulation that assumes they will simply follow (or disobey) a rule.[139] There is also the risk of regulatory backfiring – regulation may do more harm than good, for example by stifling innovation or undermining desirable features of the commercial activity being regulated. The suggestion that the legal imposition of relational norms such as trust and co-operation will crowd out *genuine* trust and co-operation is one version of this argument.

Another difficulty is that legal measures designed to regulate inequality between commercial contracting parties may come into conflict with fundamental principles of

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[134] Latham's recommendation that cross-contractual set-off clauses should be prohibited was abandoned at some point before the start of the Parliamentary process.

[135] Housing Grants, Construction and Regeneration HL Bill (1995–96) 40.

[136] See Adamson and Pollington (n 58) 21 and 53–54.

[137] Morgan (n 22) xiii.

[138] ibid 94.

[139] D Campbell, 'The incompleteness of our understanding of the law and economics of relational contract' (2004) *Wisconsin Law Review* 645, 664–65.

contract law. Regulation which directly affects the content of a contract will conflict with the principle of freedom of contract, whilst regulation which applies only to particular economic sectors undermines the classical idea that private law consists of a set of generally applicable and rationally coherent rules and principles.[140]

Teubner conceptualises these difficulties as *the regulatory trilemma*: the tension between the risk that legal regulation will have no impact on the practice being regulated at all; the risk of 'over-legalizing' the regulated practice and thereby changing it in undesirable ways; and the risk that by engaging in the task of regulation, law will become 'over-socialized' and will lose its distinctiveness and coherence.[141] These different ways in which regulation can fail mean that simple command-and-control or substantive regulatory techniques, which operate directly by mandating specific standards or outcomes, should be avoided. However, this does not mean law cannot perform any regulatory function beyond acting as an external guarantor of private ordering. Rather, Teubner argues that challenges posed by the regulatory trilemma can be tackled using *reflexive law*.

Reflexive law is procedurally orientated. It seeks to improve the quality of outcomes within the regulated activity using procedural techniques, rather than mandating specific outcomes or standards.[142] In contractual contexts, reflexive law might seek to structure the bargaining process from which contracts emerge, but having set these structural premises would leave the parties free to determine the substance of their obligations. The general law of contract as we have it is reflexive in this way, setting the boundaries of acceptable bargaining practices via doctrines such as misrepresentation, duress and undue influence, but declining for the most part to concern itself with the substance of what is agreed.[143] But reflexive law differs from the formal rationality found in classical contract law in that it does not take existing distributions as given.[144] The common law doctrines which regulate the bargaining process take a formal approach in so far as they aim to promote autonomy and choice without impacting the relative strength of the parties' bargaining positions. A reflexive approach might go further, structuring the bargaining process in ways which are intended to equalise the parties' bargaining power in order to influence the quality, although not the substance, of the outcome. Importantly, however, this strategy would only be pursued if it seemed likely to achieve the broader aims of the regulatory exercise. In a reflexive approach, the equalisation of power is a means to an end, not a normative end in itself.[145]

B. Responsive Reflexivity

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[140] Collins (n 13) 78.

[141] G Teubner, 'After Legal Instrumentalism? Strategic Models of Post-Regulatory Law' in G Teubner (ed), *Dilemmas of Law in the Welfare State* (Berlin, Walter de Gruyter, 1986) 311–12.

[142] Teubner, 'Substantive and Reflexive Elements' (1983) 254–55.

[143] The doctrine of restraint of trade is an obvious exception to this approach.

[144] Teubner (n 6) 256.

[145] Teubner, 'After Legal Instrumentalism?' (1986) 317–18.

Taken individually, the provisions of the HGCRA seem to incorporate both substantive and reflexive elements. The primary approach is reflexive: the requirement in s 108 for construction contracts to provide for adjudication, and the requirements in relation to payment in s 109–11, impose procedures rather than substantive outcomes. Moreover, the mechanism employed by these sections differs from the traditional approach found in statutes such as the Sale of Goods Act 1979 of imposing mandatory or default implied terms. They leave the parties free to devise their own terms in order to meet statutory requirements, providing flexibility and mitigating the incursion on freedom of contract. The model terms contained in the Scheme are implied into the contract only where the parties fail to take this opportunity.[146]

The right to suspend work for non-payment in s 112 and the prohibition on pay-when-paid clauses in s 113 appear on their face to be more substantive. However, in the light of the Latham Review, they can be seen as measures intended to adjust the balance of power between the parties to a construction contract not as a normative end in itself, but as a means of enhancing trust and co-operation. Overall, then, the HGCRA could be seen as an example of reflexive law.

However, thinking of the HGCRA in this way overlooks what are arguably its most theoretically interesting features. The first of these is the extent to which this statute, given its origins and content, can be seen as a joint exercise in which the Government, the industry and its clients, and ultimately the courts, participated in the development and implementation of the regulation which it contains. These features go beyond Teubner's concept of reflexive law, which assumes a clear separation of function between law as the regulating system, and the practice which is the object of regulation. Reflexivity does not capture the extent to which, as the HGCRA demonstrates, legal regulation can be product of collaborative interaction between the activities of the regulated industry, the legislature and the courts. The second is the fact that legal regulation like the HGCRA responds to the specific needs and features of particular markets or contexts. This has important theoretical implications for the third part of the regulatory trilemma, the danger that law will lose its distinctiveness and internal coherence.

We can deal with these features more effectively if we look beyond legal-centric theories. Ayres and Braithwaite's theory of *responsive regulation* is of particular assistance.[147] Addressing the broad question of how to improve the quality of government policy solutions, Ayres and Braithwaite argue that governments should seek to understand the interplay between private and public regulation in any sphere they wish to regulate, and to 'steer the mix of private and public regulation'[148] in order to achieve their policy goals. Responsive regulation or 'thinking responsively'[149] is proposed as the optimal way to do this. The core idea is that regulation should be grounded in a thorough understanding of the regulated industry. It should respond to the industry's structure, including the differing motivations of firms, and to its conduct,

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[146] Sections 108(5), 109(3), 110(3) and 110A(5).

[147] I Ayres and J Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford, Oxford University Press, 1992).

[148] ibid 3.

[149] ibid 5.

including the effectiveness of its own private regulation.[150] But thinking responsively also entails an innovative and flexible approach to choosing a regulatory response, using this contextual knowledge.[151] For example, a responsive regulator might delegate part of the regulatory function to the regulated firms themselves, via co-regulation (where the state provides oversight or ratification of regulation produced by an industry association)[152] or enforced self-regulation (where the state requires individual firms to set their own regulatory standards, failing which more onerous default standards are imposed).[153] In common with Nonet and Selznick's concept of *responsive law*,[154] a responsive approach to regulation would thus involve a more context-specific approach to the formulation of legal rules, and a widening of opportunities to participate in determining their content.[155]

Drawing on these ideas, we can achieve a more comprehensive theoretical understanding of the HGCRA if we understand it as exhibiting *responsive reflexivity*. Its reflexive provisions were adopted as part of a highly responsive regulatory exercise. Most obviously, the Latham Review provided the thorough understanding of the regulated industry which responsive regulation demands. However, events after the Review demonstrate how a responsive approach to formulating regulation can involve close, iterative communication between the institutions of state and the participants in the regulated market. Of particular note is the way in which the provisions of the Housing Grants, Construction and Regeneration Bill[156] were drafted in close consultation with the industry and client bodies which had participated in the Review. This was facilitated by the creation of an Implementation Forum chaired by Latham himself,[157] and subsequently the Construction Industry Board, whose express purpose was to provide a channel for industry and client comment on the Bill's provisions as they were being drafted.[158] The views expressed via this channel, as well as through responses to the DOE's consultation paper on the legislative proposals,[159] had an important impact on the Bill's content. In particular, the DOE appears initially to have rejected Latham's proposed 'legislative underpinning' for construction contracts reform, proposing instead a different regulatory mechanism which involved less direct interference with freedom of contract.[160] However, this was abandoned in the face of

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[150] ibid 4–5.

[151] ibid.

[152] ibid 102.

[153] ibid ch 4.

[154] P Nonet and P Selznick, *Law and Society in Transition – Toward Responsive Law*, new edn (New Brunswick, Transaction Publishers, 2001).

[155] ibid 95–100.

[156] n 135.

[157] Adamson and Pollington (n 58) ch 6.

[158] W Wilson**, S Walley, C Barclay and G Danby**, 'Housing Grants, Construction and Regeneration Bill', House of Commons Research Paper 96/58 (House of Commons Library, 1996) 65.

[159] Department for the Environment, 'Fair Construction Contracts: A consultation paper issued by the Department of the Environment' (1995).

[160] ibid.

antipathy expressed by members of the construction industry who preferred Latham's scheme.[161]

The responsive reflexivity of the HGCRA can also be seen from the way in which the Government appears to have seen its role as facilitating the creation of an industry consensus, recognising that this industry was unable to reach consensus unaided and needed support to regulate itself.[162] The provisions of the HGCRA were designed to facilitate the improved operation of the industry's own self-regulation through the standard forms, and the private regulation contained in individual construction contracts, in ways that were specifically tailored to the construction industry context.

Responsive reflexivity can also help to explain what is arguably the HGCRA's most striking feature. This is the Act's failure to specify the procedure by which an adjudicator's award is to be enforced, or the grounds on which enforcement may be resisted, reflecting Latham's view that these were matters for the courts.[163] As noted above, the HGCRA states that a contract to which it applies must provide that the adjudicator's decision is binding until the dispute is finally determined by litigation, arbitration or agreement.[164] But the Act is silent as to what should happen if the decision is not voluntarily complied with. It appears to have been assumed that the courts could be relied on to devise the enforcement procedures and principles which would be needed to ensure the effective operation of the adjudication system,[165] albeit the need for careful post-legislative scrutiny was acknowledged from the outset.[166] Despite the lack of formal consultation with the judiciary prior to its enactment, the HGCRA required the courts to create new law in order to complete its regulatory framework.

From a legal perspective this looks like surprising delegation of power and responsibility to the courts, particularly given the contrasting approach taken in the Arbitration Act 1996, which received Royal Assent shortly before the HGCRA.[167] But it can be understood in terms of responsive reflexivity. Unlike the Arbitration Act, the HGCRA applies to a narrow and carefully defined category of contracts[168] and responds

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[161] See Construction Industry Board, Minutes of Meeting No 4 on 22 May 1995 and Department of the Environment, 'Responses To Department of the Environment Consultation Paper on Fair Construction Contracts' (Department of the Environment, Construction Sponsorship Directorate 1995).

[162] See for example *Hansard* HL Deb Vol 569, col 1025 (20 Feb 1996).

[163] Latham (n 64) 90–92.

[164] Section 108(3).

[165] Latham (n 64) 90–92. The failure to specify these matters in the statute and the corresponding delegation of power and responsibility to the courts which that failure entailed was not raised as an issue in the Parliamentary debates.

[166] *Hansard* HL Deb Vol 574 col 1350 (23 July 1996).

[167] Sections 66–73 of the Arbitration Act 1996 contain a detailed and comprehensive code governing the procedure for enforcement of an arbitrator's award, the grounds on which enforcement may be resisted, the procedures and grounds on which an award may be challenged or appealed by a dissatisfied party, and the circumstances in which the right to raise particular objections may be lost.

[168] See n 53 and the accompanying text.

to particular features of the context in which those contracts operate. One important feature of that context is the longstanding existence of a respected specialist judiciary. Moreover, the HGCRA can be seen as an example of what Collins has identified as 'meta-regulation', which seeks to regulate the law of contract itself.[169] Its regulatory technique is to steer and modify the operation of contract law by regulating the terms of construction contracts. Against this background, the decision to make the courts responsible for determining the rules and procedures governing adjudication enforcement can be seen as a way of providing responsive reflexivity in the HGCRA's meta-regulatory exercise. The minimal requirements of s 108 gave the courts an important measure of freedom in deciding how to integrate adjudication into the law of contract.

C. Responsive Reflexivity and the Regulatory Trilemma

The responsive aspects of the HGCRA address the first two aspects of Teubner's regulatory trilemma: the risk that legal regulation will have no impact on the regulated practice, and the risk that it will have an undesirable or unanticipated impact. The close involvement of the construction industry and its clients in the creation of this statute reduced these risks to the maximum possible extent and resulted in a statute which was tailored to their specific needs.[170] However, these same elements serve to increase pressure on the trilemma's third element, the risk that law will lose the distinctiveness and coherence of its own internal discourse. In particular, responsiveness poses an inherent challenge to the idea of contract law, and private law more broadly, as a set of generally applicable and formally coherent rules and principles.

The most visible manifestation of this tension in the events leading to the enactment of the HGCRA occurred in relation to Latham's proposals to reform the law of joint and several liability and limitation for construction defects which, as noted above, did not find their way into the Housing Grants, Construction and Regeneration Bill due to a lack of consensus among the industry and its clients. The DOE's consultation exercise on these proposals[171] revealed considerable opposition from the English and Scottish Law Commissions, and the legal profession more generally. Although the proposals involved significant interference with freedom of contract, being less reflexive than the proposals on construction contracts reform, the focus of objection was their interference with the generality of the rules of private law. From the perspective of legal discourse, the proposal to modify the rules of private law so extensively in their application to one particular industry was considered somewhat shocking, as well as undesirable as a matter of principle and policy.[172] The consultation responses received

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[169] H Collins, 'Regulating Contract Law' in Christine Parker and others (eds), *Regulating Law* (Oxford, Oxford University Press, 2004) 28.

[170] The HGCRA even goes so far as to exclude from its scope of application particular subsectors of the construction industry which were not affected by the problems identified in the Latham Report and whose representative bodies rejected the need for legislative intervention in their activities: see ss 105–06.

[171] Department of the Environment, ' Latent Defects Liability' (1995).

[172] See in particular Letter from Professor Andrew Burrows, Law Commissioner, to Mr E Criswick, Department of Environment (24 May 1995).

from the Law Commissions,[173] the Lord Chancellor's Department,[174] academic lawyers[175] and the legal profession more generally[176] were also sceptical as to whether modifications to these general rules in the case of the construction industry were justified, and felt that any reforms should be the subject of a Law Commission Review before being pursued any further. In Teubner's terminology, this can be seen as reflecting a concern to protect the integrity of legal discourse.

The proposals which were included in the Bill, and ultimately the HGCRA itself, attracted less opposition from the Law Commissions and other legal groups, although this may in part have been because they were not fully consulted upon.[177] Nonetheless the regulation of particular contract types, despite being relatively common in English law, poses a similar challenge to ideas of generality and coherence. The findings of the Latham Review demonstrate that, when considering the importance of this challenge, the rest of the regulatory trilemma remains in play. If the general rules of contract law are insufficiently responsive to the needs of a particular area of commercial activity, they may have little or no impact in that area. This can undermine the creation of trust and co-operation in commercial contexts like the UK construction industry, which rely on legal sanctions and regulation. Where generality and coherence have a practical cost, this should be squarely acknowledged and properly addressed.

VII. Conclusion

This chapter has sought to highlight a blind spot in commercial contract scholarship, consisting in a failure to fully recognise that inequality can exist in commercial contexts, and that where it exists it can be a barrier to the creation of trust and co-operation if it is not regulated. The regulation of inequality can take many forms. It might consist in the existence of standard terms or payment practices whose use is de facto obligatory for participants in a given industry, restricting the ability of more powerful firms to bargain for different terms or practices which would disadvantage weaker contacting parties.[178] It might consist in the creation through trade rules of a dispute resolution mechanism which allows payment disputes to be resolved quickly and cheaply, addressing the problem that 'when a little guy [merchant] isn't paid, he may suffer huge financial harm'.[179] Or it might consist in less formal norms which mean certain types of conduct

[173] ibid and Scottish Law Commission, 'DOE Consultation Paper: Construction Projects: Latent Defects Liability and 'BUILD' Insurance – Response by Scottish Law Commission' (16 June 1995).

[174] Letter from the Lord Chancellor's Department to Sir Christopher Foster (16 June 1995).

[175] Letter from Ewan McKendrick to Mr E Criswick, Department of Environment (30 May 1995).

[176] Department of Environment, 'News Release – Responses to Consultation Paper on Latent Defects Liability and 'BUILD' insurance' (19 July 1995).

[177] As noted above, the DOE's only consultation paper on construction contracts reform set out proposals which were very different from those which were ultimately adopted in the Bill.

[178] See section III above.

[179] Bernstein, 'Cotton Industry' (2001) 1741 fn 78.

will result in reputational damage and a consequent loss of business.[180] In different contexts, inequality may be regulated by a combination of some or all of these techniques. But in some contexts, like the UK manufacturer–supplier relationships considered in the Cambridge Study or the UK construction market at the time of the Latham Review, the main source of regulation is contract law. The Latham Review's findings show how real difficulties can ensue if contract law does not perform this crucial regulatory function in a way which meets the needs of a particular commercial market.

The chapter has argued that contract scholars should pay more attention to markets where contract law performs this regulatory role, and in particular those markets where the general law of contract has been modified or supplemented by a context-specific legal regime. We should consider the dynamics of this legal regulation, how it came to be enacted, how it operates in practice, and how it seeks to overcome the inherent challenges of regulating commercial contracts. We should give greater consideration to the ways in which theories of regulation may be relevant to theories of contract law.

The examination of these issues through an in-depth study of the HGCRA has demonstrated that the regulation of contracts need not be paternalist or welfarist in the narrow sense of seeking to improve substantive fairness or protect weaker parties as an end in itself. Regulation might seek to rebalance power within a given category of contracts as a means to an end, such as the facilitation of more trusting and co-operative relations in the regulated sector. It has also shown that legal regulation need not involve the rigid imposition of external norms or allocations of substantive rights and obligations. It can instead operate reflexively, imposing procedural requirements designed to influence but not directly control the parties' self-regulation through the terms of their contract. And, finally, it has shown how regulation can mitigate the twin risks of having no impact at all on the regulated practice, or of having an unanticipated negative impact, if it is responsive as well as reflexive.

The concept of responsive reflexivity developed in this chapter is not a complete answer to Teubner's regulatory trilemma, because it poses a distinctive challenge to the trilemma's third limb, the risk that law will lose the distinctiveness and coherence of its own discourse. Responsive reflexivity challenges the classical idea of contract law as a set of generally applicable rules and principles because it is more likely to involve the creation of particular rules for particular contract types. However, we should not overstate the importance of this classical idea, given the extent to which modern English contract law already contains such context-specific rules and principles. Although academic accounts of contract law focus on rules of general application, the leading practitioner textbook, *Chitty on Contracts*,[181] consists of two volumes of roughly equal size, dealing with 'General Principles' and 'Specific Contracts' respectively. And in practice, many different types of commercial contract attract their own cadres of specialist lawyers who rely principally on their own specialist textbooks and pursue

[180] See for example Macaulay (n 2) 63–64 and Beale and Dugdale, 'Contracts Between Businessmen' (1975) 47–48 and 51–52.

[181] H Beale (ed), *Chitty on Contracts*, 33rd edn (London, Sweet and Maxwell, 2018).

litigation in specialist courts.[182] We should also balance the urge for coherence in legal discourse against the practical consequences which, as events leading to the HGCRA demonstrate, can ensue when legal rules are insufficiently responsive to the needs of a particular sphere of commerce.

[182] Following the creation of the Business and Property Courts in June 2017, disputes arising from commercial contracts may now be dealt with by a number of specialist courts, including the Commercial Court, the Technology and Construction Court, the Business List, the Admiralty Court, the Commercial Circuit Court (previously the Mercantile Court), the Financial List and the Intellectual Property List. Many of these specialist courts, such as the Commercial Court, the Admiralty Court and the Technology and Construction Court, have a long history.