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Payment Provisions

Let the payer be aware!

Firstly, a brief recap. The Housing Grant Construction and Regeneration Act of 1996 (the Construction Act) introduced into all construction contracts for work in the United Kingdom, specific payment provisions. There were only limited exceptions principally contracts relating to residential occupiers. There were two particular provisions.

1.1 Section 110(i)(a) provided that every construction should provide an adequate mechanism for determining when payments became due and Section 110(ii) obliged a paying party to give notice no later than 5 days after the date when a sum became due specifying the amount to be paid and the basis upon which it was to be calculated.

1.2 Section 111(i) of the Construction Act provided for the paying party to serve an effective notice withholding, if it wished to pay less than the sum that was due, specifying in that notice the amount to be withheld and the grounds for doing so. That notice had to be served before the sum claimed became finally due.

1.3 If the contract did not contain these provisions then they were implied into the contract from

the Scheme for Construction Contracts which provided, for example, that such a holding notice had to be served no later than 7 days before the final date for payment.

1.4 Section 111 of the original Act worked tolerably well, if parties were going to set off sums against monies otherwise due then they had to serve a written notice saying so before that sum became finally due. The problem was, however, with Section 110 as it lacked any sanction for non-compliance. As was said in SL Timbers Assistance Limited -v- Carillion Construction Limited, 2001 BLR 216, a failure to serve such a notice was an administrative failure which did not of itself result in the sum claimed becoming the sum due unless, the contract so stipulated.

1.5 The contract did so stipulate in the JCT standard form of design and build contract of 1988 and as a consequence of failure by the employer to serve a notice of payment in response to a contractor's application, meant that the employer was obliged to pay the amount stated in that interim application.

1.6 If, however, the contract contained no such stipulation, the party applying for payment, or invoicing could not be sure whether, and if so how much, the paying party was going to pay until the sum claimed became finally due. If the payee then took the non-paying party to adjudication it was open to the latter to argue that the sum claimed was not in fact due, see Rupert Morgan Buildings Services Limited -v- Jervis 2004, 1WLR 1867.

1.7 10 years after the Construction Act came into force, it was amended by the Local Democracy Economic Development and Construction Bill of 2008 which came into force on 1 October 2011 and applied to all contracts entered into after that date.

1.8 The issue of the payee not knowing how much he was going to be paid was addressed by attaching teeth to the Section 110 payment notice by amending Section 111 to state that where a notice complying with Section 110(a)(ii) had been given then that "notified sum" had to be paid unless there was a compliant notice to pay less.

1.9 There are essentially two types of contract when it comes to the payment provisions. There are the payer notice contracts typified by standard form building contracts where the payment process is initiated by the payer, the employer notifying the payee, the contractor by way of a certificate or valuation how much he is to be paid.

1.10 Under other contracts, such a consultant appointments and many subcontracts, the initial payment notice comes from the payee by way of an application for payment or an invoice.

1.11 Under the payer led notice system, if the payer serves no notice, either a certificate is issued or it is issued too late, then the supplier's application for payment, or a later notice can become the notified sum and this eventually can become the amount due and payable, unless the payer serves a timely "pay less notice".

1.12 Equally, where the contract is a payee led notice type, if the payer fails to serve any notice in response to the application for payment or invoice, the sum applied for becomes the sum due.

1.13 As a consequence, once the majority of construction contracts entered into and those concluded after 1 October 2011, there was a spate of what have been called "smash and grab" adjudications.

1.14 In these adjudications, the paying party had failed to serve the payment notice, or very frequently failed to serve it in accordance with the contractual timetable and had not thereafter recovered their position with a timely pay less notice. As a consequence, the adjudicator applying the amended payment provisions was bound to award the payee the sum claimed even when on further examination that sum claimed was excessive.

1.15 In ISG Construction Limited -v- Seevic College 2014, EWHC 4007, Seevic failed to serve a payment notice in response to an application for payment of over £1 million. As the application was not paid, ISG commenced an adjudication proceeding on the basis that as no payment notice had been received, that sum was bound to be due. Seevic, anticipating the result of that adjudication, commenced their own adjudication before the conclusion of the first adjudication, seeking to challenge the value of the application and they anticipated the adjudicator's decision based upon it.

1.16 The first adjudication decision was, as anticipated, in line with the amount of the original application plus interest. However, the second adjudication decision, provided, after an examination of the component elements of the application a much lower value. Both parties went to Court to enforce their respective decisions, but the court declined to enforce the second ruling stating that the employer had "no right to demand a valuation of the contractor's work on any date other than the valuation dates for interim application specified in the contract.

1.17 Of course, the main party could seek to recover the position on the subsequent interim valuation date, but if the contract was nearing its end or had been determined, that option would not be available.

1.18 Because in part of the serious consequence of a failure by a paying party to serve any adequate notices to might be an inflated application for payment, the courts and paying parties began to pay close attention to the validity of the initial payment application, checking in particular whether it was made in the correct form and in a timely manner.

1.19 In Leeds City Council -v- Waco 2015 EWHC 1400 (TCC), the contract, Waco, had made a series of applications for payment up to practical completion which had been a few days after the contractual application dates. The employer had paid. In the proceedings, the judge found that there had been a course of conduct which accepted monthly applications which were up to 3 to 4 business days late.

However, in the post practical completion period, applications were to be made every 2 months, the judge found that Waco had made a premature application which had not been paid and in relation to which no payment notice had been served. An adjudication was commenced and the adjudicated awarded the sum claimed which Leeds City Council paid.

They then commenced what is called Part 8 proceedings. These are proceedings in which a short issue of contractual interpretation which does not involve hearing factual evidence can be brought before a court for determination. It is now not uncommon for such applications to be heard alongside applications to enforce summary judgments, where the party seeking to resist enforcement is doing so by attempting, in its part application, to demonstrate that part or all

the adjudicator's decision on a proper analysis is legally wrong and therefore the adjudication decision should not be enforced.

1.20 In the Waco case Leeds City Council had in fact paid the amount of the adjudicator's decision, but their Part 8 application was successful such that the judge found that the application for payment had been premature, and therefore invalid and as a consequence the adjudication decision was also invalid. Waco were directed to re-pay the amount of the decision plus interest to Leeds City Council.

1.21 In a similar vein in Caledonian Modular -v- Mar City Developments Limited 2015, EWHC 1855, the contractor had made an application to which there was no timely payment or pay less notice. He took the matter to adjudication where he was awarded the amount of the application of some £1.5 million. Upon enforcement, the paying party again deployed Part 8 proceedings and the judge found when interpreting the contractor's application that it was not a valid application for payment and as a consequence the adjudicator's decision was not to be enforced.

1.22 In Harding -v- Paice 2015 EWCA Civ 1231, the dispute concerned the final account. The employer failed to serve a proper payment notice in reply to the contractor's final account application. In the following adjudication, the contractor was awarded the sum of his claimed final account.

1.23 The employer then commenced a second adjudication to determine the true value of the final account and the contractor applied for an injunction to restrain the continuation of that adjudication on the basis that that issue had already been decided in the first adjudication.

1.24 The judge found that the absence for proper payment notice did not prevent the paying party commencing an adjudication for value on its final account, and in doing so distinguished final accounts from interim accounts as found ISG -v- Seevic. Lord Justice Jackson had this to say, "in the present case we are concerned with the final account following termination of the construction contract. Clause 8.12.5of the contract conditions requires an assessment of the amount which is "properly due in respect of the account". The Clause expressly permits a negative valuation. Mr Linnett (the adjudicator) did not carry out any such valuation exercise in the third adjudication. Therefore, PS was entitled to refer that dispute resolution in the aborted fourth adjudication. They will be entitled to do so again in the proposed fifth adjudication."

1.25 What lessons are to be drawn by paying and receiving parties to construction contracts by these amendments and the cases that have flowed from them?

1.26 Paying parties need to pay close heed to the actual payment provisions of the contract which they have entered into and to apply them. If the contract says valuations/certificates should be

issued every 28 days, **make sure that it is 28 days and not 30 or 31**. Aide memoire drawn up to remind those responsible would be a handy tool.

1.27 For receiving parties, equally make sure your applications are issued on time, a day or two late may be acceptable but certainly never too early, and ensure that the application is clear and unambiguous, avoid words such as draft, advisory, indeed anything that detracts from it being clearly an application for a definite sum of money which shows clearly how it has been calculated.

1.28 As Coulson J said in Caledonian Modular -v- Mar City Developments Limited, *in the UK*, *the employer's failure to serve a pay less notice within a short period challenging the payee's notice can have draconian consequences. A failure to serve a notice in time will usually mean a full liability to pay. That is what the run of recent TCC cases on this topic including ISG -v- Seevic and Galliver Tri Building Limited -v- Estura Limited are all about. But it seems to me that, if contractors want the benefit of these provisions, they are obliged, in return, to set out their interim payment claims with proper clarity. If the employer is to be put at risk that a failure to serve a payless notice at the appropriate time during the payment period will render him liable in full for the amount claimed, he must be given reasonable notice that the payment period has been triggered in the first place.*

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