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BRIEFING

PAY LESS NOTICES AND FINAL ACCOUNTS

NOVEMBER 2017

- COURT OF APPEAL FINDS THAT PAYMENT REGIME IN CONSTRUCTION ACT 1996 APPLIES TO FINAL AND TERMINATION PAYMENTS
- EMPLOYERS SHOULD ENSURE THAT THEY SERVE VALID PAY LESS NOTICES AS SOON AS POSSIBLE

Cash-flow problems have long been an issue for those in the construction industry. In order to address such issues and to protect contractors against the risk of insolvency, the UK Parliament passed the Housing Grants, Construction and Regeneration Act 1996 ("the Act"), as amended by the Local Democracy, Economic Development and Construction Act 2009. Sections 110 and 111 of the Act set out a payment regime detailing what payments are to be made and when they are to be made, which is to be implied into contracts which do not themselves include a regime which complies with the Act.

"CASH-FLOW PROBLEMS HAVE LONG BEEN AN ISSUE FOR THOSE IN THE CONSTRUCTION INDUSTRY."

In short, the statutory regime provides for the service of a "Payment Notice", specifying a sum said to be due and setting out a final date for payment. If an employer wants to dispute a sum certified in a Payment Notice, it must serve a "Pay Less Notice" on the contractor not less than seven days before the final date for payment, setting out the lesser sum which is said to be due together with an explanatory calculation.

If the employer fails to serve a Pay Less Notice either at all or on time, it has no right to withhold the Payment Notice sum. In that situation, a contractor will often commence what has become known as a "smash and grab" adjudication, relying on the technical argument of non-compliance to compel the employer to make payment in full, even if the sum in the Payment Notice has been miscalculated. The employer will then be left in the invidious position of having to recover any over-payment from the contractor.

As the statutory regime only applies if the relevant contract does not already contain compliant provisions, bespoke payment regimes have been added to industry standard form contracts.

The result is a "pay now, argue later" system which has improved cash-flow, but which puts pressure on an employer to scrutinise Payment Notices in short order and raise objections at an early stage.

Although it was clear that the statutory payment regime applied to interim payments which became due during the term of a construction contract, there was uncertainty as to whether the regime also applied to final or termination payments. This issue was recently considered by the Court of Appeal in an important case between the architect firm Adam Architecture Ltd ("Adam") and the employer, Halsbury Homes Ltd ("Halsbury")[1].

The Facts

In October 2015, Adam contracted with Halsbury to provide design work in connection with the construction of 200 homes on land at Loddon in Norfolk.

The contract between Adam and Halsbury was subject to a similar Payment Notice regime to that in the Act, with some deadlines having been amended by the incorporation into the parties' contract of the Conditions of Appointment published by the Royal Institute of British Architects.

On 2 December 2015, not long after instructing Adam, Halsbury radically changed the scope of the work. On the next day, Adam wrote to Halsbury, effectively stating that its work on the construction project was at an end, and enclosing a final account invoice in the amount of £46,239. Halsbury failed to pay either that final invoice or an earlier invoice for £747[2] and did not serve Pay Less Notices by the final due dates for payment.

"THE COURT OF APPEAL UNANIMOUSLY HELD THAT THE PROVISIONS IN SECTIONS 110 AND 111 OF THE ACT EXTEND TO FINAL AND TERMINATION PAYMENTS, AS WELL AS INTERIM PAYMENTS."

Adam brought an adjudication against Halsbury, which found in favour of Adam, largely because Halsbury had failed to serve Pay Less Notices. The matter was referred to the High Court, which found in favour of Halsbury, before being appealed to the Court of Appeal, which handed down an important judgment for the construction industry on 2 November 2017.

The Judgment

The Court of Appeal unanimously held that the provisions in sections 110 and 111 of the Act extend to final and termination payments, as well as interim payments. As Halsbury had failed to serve Pay Less Notices, it was obliged to pay Adam's invoices in full.

The Court's decision was primarily based on a careful reading of sections 109 to 111 of the Act. The Court recognised that, in line with its objective to facilitate cash-flow in the industry, the principal target of the Act was interim payments. However, it was not limited only to them. The Court found that, although section 109 relates only to interim payments, sections 110 and 111 are drafted in sufficiently broad terms so as to apply the statutory payment regime to all payments provided for by a

[1] *Adam Architecture Limited v Halsbury Homes Limited* [2017] EWCA Civ 1735

[2] The Court of Appeal's judgment also explains that a credit note of £1,246 was issued by Adam in early 2016, but nothing turns on that point.

construction contract. The Court saw no reason to read what they saw as a "sensible and workable" provision in any other way. An analysis of the case law only fortified the Court of Appeal's view.

One other issue stood in the way of a successful claim by Adam, which was whether its 3 December 2015 letter amounted to an acceptance of Halsbury's attempted repudiation of the parties' contract. If it did amount to an acceptance, Adam could not rely on contractual provisions to demand up-front payment from Halsbury, the contract having been brought to an end as a result of Adam's acceptance of Halsbury's repudiatory breach. If so, Adam would have to sue Halsbury for damages if it wanted to make a recovery. The Court of Appeal reached the common-sense conclusion that Adam's letter did not have this effect, or in the more colourful language of Lord Justice Jackson, Adam had not "shot itself in the foot by putting an end to the very contractual provisions upon which it was relying." The Court considered that Adam had a "cast iron case" to recover payment of its invoices.

Conclusions

The payment regime in the Act has already had a significant impact upon the construction industry. The Court of Appeal's judgment in *Adam Architecture* now confirms that the payment regime also extends to final and termination payments.

"FOR EMPLOYERS, THE IMPORTANCE OF SERVING A VALID PAY LESS NOTICE HAS INCREASED EVEN FURTHER, AS HAS THE NEED TO SCRUTINISE EACH PAYMENT NOTICE AT THE EARLIEST POSSIBLE MOMENT."

The decision will be welcomed by contractors as consistent with the underlying statutory purpose to ensure that cash-flow is facilitated and that disputes are capable of quick resolution. For employers, the importance of serving a valid Pay Less Notice has increased even further, as has the need to scrutinise each Payment Notice at the earliest possible moment. As is the case for interim payments, a failure to serve a valid Pay Less Notice in relation to a final account payment can leave an employer open to "smash and grab" adjudications. However, the stakes are much higher at final account stage, where there will be no opportunity to correct over-payments during subsequent payment cycles. In those circumstances an employer may have to seek a court order staying enforcement, particularly if the contractor is impecunious or if payment in full will cause the employer real financial difficulties, as was the case in *Galliford Try Building Ltd v Estura Ltd*[3] which we covered in an October 2015 briefing note.

[3] [2015] EWHC 412 (TCC)

FOR MORE INFORMATION

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Publication code number: 61109178v1