



## Updating the Construction Act

### Payment: The Bill and current case law

#### Introduction

1. This paper focuses on some of the issues that have arisen in respect of the payment provisions of sections 109 to 113 inclusive of the *Housing Grants, Construction and Regeneration Act 1996* (“HGCRA”). More specifically, each section deals with:
  - (i) Section 109 - a right to payment by instalments;
  - (ii) Section 110 - the requirement for an “adequate payment mechanism and payment notice”;
  - (iii) Section 111 - withholding notices;
  - (iv) Section 112 - a right to suspension if the sum due is not paid in full; and
  - (v) Section 113 - conditional payments.

#### What was the purpose of these payment provisions?

2. For many years, the construction industry has unfortunately been plagued with the reputation that construction contracts, by their very nature, will generate disputes regarding payment.<sup>1</sup> Those who are engaged to perform the work often consider themselves entitled to extra payment for delay and variations, while those who have had work carried out often have good reasons why payment is not due, for example defects. Cash flow between the contracting parties has therefore become a major concern in the industry.
3. In 1971 the courts attempted to provide assistance to those contractors to which payment was being withheld. In the Court of Appeal decision *Dawnays Ltd v F G Minter Ltd*<sup>2</sup>, Lord Denning MR held that architects’ certificates under standard forms of building contracts were to be regarded in the same way as a cheque or cash as ‘*cash flow was the very lifeblood of the enterprise*’. He stated:

“Every businessman knows the reason why interim certificates are issued and why they have to be honoured. It is so that the sub-contractor can have the money in hand to get on with his work and the further work he has to do. Take this very case. The sub-contractor has had to expend his money on steel work and labour. He is out of pocket. He probably has an overdraft at the bank. He cannot go on unless he is paid for what he does as he does it. An interim certificate is to be regarded virtually as cash, like a bill of exchange. It must be honoured. Payment must not be withheld on account of cross-claims whether good or bad - except so far as the contract specifically provides. Otherwise any main contractor could always get out of payment by making all sorts of unfounded cross-claims.”

4. In this case it was held that the subcontractor could recover the sum due to them pursuant to an interim certificate and the main contractor was not permitted to deduct unliquidated damages by reference to his claimed delay. However, the 1973 House of Lords’ decision in *Gilbert-Ash (Northern) Ltd v Modern Engineering (Bristol) Ltd*<sup>3</sup> reversed this position. As a result, an employer who wanted to avoid an interim payment to his

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1. See May LJ’s judgment in *Pegram Shopfitter Ltd v Tally Wiejl (UK)* [2003] EWCA Civ 1750.

2. [1971] 2 All ER 1389.

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contractor was able to do so by simply putting together a cross-claim. This situation was considered to be grossly unsatisfactory as monies were not flowing from the employer, to the main contractor, and finally, the subcontractor. By the 1990s the construction industry was in a dire state of affairs as the problem of non-payment was affecting the economic stability of the construction industry.

5. In July 1993, it was announced that there was to be a Joint Review of Procurement and Contractual Arrangements in the UK construction industry, funded by the Department of the Environment, and conducted by Sir Michael Latham. His final report, "*Constructing the Team*" was published in December 2003. It was extremely wide-ranging<sup>4</sup>, and also included specific recommendations for payment provisions to be implied into building contracts and the use of adjudication as a mandatory process for dispute resolution. He considered that all construction and engineering contracts should include a general duty to trade fairly (with specific requirements relating to payment and related issues), clearly defined work stages, pre-pricing of variations, and an adjudication system which was independent of contract administration.<sup>5</sup> He also concluded, with respect to non-payment, that if an employer or main contractor wanted to use its rights of set-off, it had to be done within a very short timeframe following the issue of the certificate or request for payment.
6. Following Latham's Report, the HGCR was introduced in 1996 with the aim of resolving disputes quickly, unlocking cash flow, and allowing the project to continue efficiently with certainty of payment. It sought to impose terms for payment on commercial contracts regardless of whether or not the parties were of equal or unequal bargaining power. Where the contract provisions comply with the HGCR payment provisions of sections 109-113, they remain effective; however, where they are non-compliant, or no provision is made at all, the Scheme for Construction Contracts will apply.
7. Sections 109-111 aim to ensure that all construction contracts contain a clear mechanism for interim payments to the contractor/subcontractor. They also impose an obligation on the payer to notify the payee, in advance of the due date, how much is going to be paid and how that sum has been calculated. If monies are to be withheld, then the payer must notify the payee how much will be withheld and why.

## Section 109

8. Section 109 of the HGCR states:

- "(i) A party to a construction contract is entitled to payment by instalments, stage payments or other periodic payments for any work under the contract unless:
  - (a) it is specified in the contract that the duration of the work is to be less than 45 days, or
  - (b) it is agreed between the parties that the duration of the work is estimated to be less than 45 days.
- (ii) The parties are free to agree the amounts of the payments and the intervals at which, or circumstances in which, they become due.
- (iii) In the absence of such agreement, the relevant provisions of the Scheme for Construction Contracts apply.
- (iv) References in the following sections to a payment under the contract include a payment by virtue of this section."

3. [1973] 3 WLR 421.

4. Including topics on "Role of Clients", "The Design Process", "Selection and Tendering Procedures", "Team Work on Site" and "Liability Post-Completion".

5. Refer to paragraph 5.17(4) of the Latham Report.

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9. The purpose of section 109(1) is to introduce a stage payment mechanism in all contracts of any duration if the work is to take more than 45 days. This provision is considered in the case of *Tim Butler Contractors Limited v Merewood Homes Limited*<sup>6</sup>. The defendant sought to avoid enforcement of an adjudicator's decision, arguing that section 109 did not apply because the works were to take less than 45 days. The adjudicator had concluded that the parties had agreed the essential terms, such as price, scope, works and commencement date, but had not identified a date for completion nor reached an agreement as to the duration of the works. A programme indicated that the works were to be completed within four weeks, but the adjudicator considered that that programme was not a part of the contract. The adjudicator therefore came to a conclusion about how much should be paid and made a decision in favour of the claimant.
  10. The defendant raised the same arguments again at the enforcement application before HHJ Gilliland QC. His Honour rejected the defendant's arguments, concluding that there was a contract. His Honour found that the adjudicator had come to the correct conclusion and therefore enforced the award. Interestingly, he also concluded that a dispute as to the terms of the contract was a dispute that did not deprive the adjudicator of his jurisdiction. In other words, if the parties were both in agreement that there was a contract, but were arguing about the terms of that contract, then the adjudicator had jurisdiction and could make a decision about which terms were in fact incorporated within the contract.
  11. This must no doubt depend upon whether the parties have agreed to, or simply by default, provided the adjudicator with that jurisdiction. In the case of *Pegram Shopfitters Ltd v Tally Wiejl (UK) Ltd*<sup>7</sup> the parties considered that there was a contract but could not agree on which terms applied. The adjudicator came to a conclusion about the terms that applied, on the basis that there was a contract and therefore he had jurisdiction. At first instance, HHJ Thornton QC agreed with that approach and enforced the decision. However, the Court of Appeal considered that the analysis was not simply one of coming to a conclusion as to the terms that prevailed. They concluded that in such a situation there were three alternatives:
    - (i) that there was no construction contract in writing;
    - (ii) if there was, then it was a different contract such that different adjudication rules applied and therefore the adjudicator did not have any jurisdiction. The claimant argued that the contract was under the JCT Standard Form of Prime Cost Contract 1998, while the defendant contended that the contract was based upon a standard form that they had proposed. This "battle of the forms" raised the issue as to the appropriate terms that might apply to any construction contract, providing that a construction contract had of course formed;
    - (iii) there was no contract at all, so that the claimant was due to be paid a reasonable sum. If there was no contract, then there could be no contract in writing for the purpose of the HGCRA such that the adjudicator could not obtain jurisdiction under the Scheme. Further, the determination of the applicable terms had an effect on the amount that could be claimed pursuant to those terms.
  12. Lord Justice May held that the judge had based his decision on the premise that both parties had agreed that their relationship was governed by a
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6. [2002] 18 Const LJ 74.

7. [2003] EWCA Civ 1750.

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construction contract, and therefore all that was to be done was to determine the terms of that contract. Lord Justice May considered that this was wrong and that the parties had not agreed that there was a construction contract. He stated at paragraph 32:

“Mr Hyam submits that, where the factual matrix demonstrates an intention on both sides to be bound by written contractual terms of a building contract, the subject matter of which is certain and evidenced by extensive communications between the parties; where the work is complete but there remains a residual dispute as to the terms under which the work was carried out, an adjudicator or judge is entitled to conclude that there is no realistic prospect of the defendants establishing that there was no contract in existence, and thus no jurisdiction of the adjudicator to adjudicate. I agree that a judge would be entitled so to conclude in appropriate circumstances, but I do not consider that these are such circumstances. It seems to be at least arguable either that there was a contract here, but upon JCT Prime Costs Terms, or, perhaps more likely, that there was no concluded written construction contract. The judge’s recitation of the facts and the analytic contortions evidenced in paragraphs 30 and 31 of his judgment, including his characterisation of the situation as “a construction contract whose terms cannot be readily ascertained” suggests to me a real possibility that there was no written construction contract.”

13. He did not accept that the identification of the precise terms of the construction contract was a “*matter of detail which did not impugn the existence of the contract.*” A submission that Lord Justice May considered was “palm tree contractual analysis.”

14. The appeal was allowed and the judge’s order set aside. Lady Justice Hale agreed, as did Mr Justice Hooper. Lady Justice Hale added:

“My view is that the most likely analysis of the legal relationship between the parties was either a contract or a quasi-contractual claim under which, the price not having been agreed, a quantum meruit was payable. Neither of those analyses is a contract in writing under the Section 107, and accordingly Section 108 did not apply.”

## Section 110

15. Section 110 reads as follows:

“(i) Every construction contract shall -

- (a) provide an adequate mechanism for determining what payments become due under the contract, and when, and
- (b) provide for a final date for payment in relation to any sum which becomes due.

The parties are free to agree how long the period is to be between the date on which a sum becomes due and the final date for payment.

(ii) Every construction contract shall provide for the giving of notice by a party not later than five days after the date on which a payment becomes due from him under the contract, or would have become due if -

- (a) the other party had carried out his obligations under the contract, and
- (b) no set-off or abatement was permitted by reference to any sum claimed to be due under one or more other contracts,

specifying the amount (if any) of the payment made or proposed to be made, and the basis on which that amount was calculated.

(iii) If or to the extent that a contract does not contain such provision as is mentioned in subsection (1) or (2), the relevant provisions of the Scheme for

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Construction Contracts apply”. [Emphasis added]

16. The first sub-section of section 110 merely requires the parties to a construction contract to set out a mechanism for determining what payments become “due under the contract” and the mechanism for identifying when those payments become due and identifying a final date for payment of that sum. The parties can agree on the detail of the mechanism, and those standard forms that are commonly encountered within the industry appear to comply with the requirements of this section. Sub-section 1 merely sets out the framework within which the parties to a construction contract must operate. If parties do not include a payment mechanism within their construction contract, then the relevant provisions of the Scheme will apply by virtue of sub-section 3.

### Adequate mechanism

17. Quite what constitutes an “adequate mechanism” under section 110(1)(a) is unclear. Lord MacFadyen in *Maxi Construction Management Limited v Mortons Rolls Limited*<sup>8</sup> gave some consideration to this issue. The contractor, Maxi Construction, contended that they were entitled to an interim payment in respect of application no. 10. There was some debate about which terms had been incorporated into the contract, and ultimately the decision turned upon the nature of the contractor’s submission for payment.
18. The contract in question required the employer’s agent to agree the valuation with the contractor before making a claim for payment. There was no obligation on the employer’s agent to agree a valuation within a clear timescale. As this effectively meant that a claim for payment could be delayed indefinitely, Lord MacFadyen held that it was an inadequate mechanism. A payment provision that does not provide a clear timescale for dealing with and resolving payment issues is therefore inadequate, but Lord MacFadyen does not offer any guidance as to a test that could be applied in order to determine whether a payment mechanism is adequate or inadequate.
19. The more interesting aspect of section 110 is the payment notice contained in sub-section 2. The paying party is supposed to serve a notice on the other party specifying the amount of the payment or the amount to be paid, and the basis of that payment. The notice should identify the amount due under the contract, assuming that the other party had carried out its obligation under that contract, and ignoring set-off or abatement in respect of other contracts.
20. The case of *Alstom Signalling Limited v Jarvis Facilities Limited*<sup>9</sup> considered the requirement for a “final date” to be identified in the contract. In that case, the defendant argued that the final date for payment could be altered by the paying party, and therefore it was not possible to identify a final date for payment in the manner anticipated by the HGCRA. The payment terms in the subcontract required payment within seven days of the Railtrack Certificate under the main contract. The subcontract was therefore dependent upon the issue of the Railtrack Certificate under the main contract, rather than the subcontract.
21. However, HHJ Lloyd QC held that the final date for payment could still be identified. It was seven days after the Railtrack Certificate. If Railtrack failed to issue the certificate then they would be in breach of contract, but that did not mean that it was not possible to identify the date upon which it should have been issued and therefore the final date for payment under the subcontract. HHJ Lloyd QC stated that, notwithstanding the

8. Outer House, Court of Session, Lord Macfadyen, 7 August 2001.

9. [2004] EWHC 1285 (TCC).

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absence of a withholding notice, the paying party may still establish later what was truly due to be paid, by the use of the appropriate contractual procedures or proceedings. However, this is done by rehearing the dispute afresh in subsequent proceedings, so not by withholding.

22. His Honour simply came to the conclusion that the final date for payment remained seven days after issue of the Railtrack Certificate and therefore was identifiable. The fact that the final date for payment was identified by reference to a future event did not make it invalid. The final date for payment did not need to be set out on a regular monthly basis. It could relate to a milestone date, or a series of stage payments either monthly or at some other interval, or bear reference to stages of the work. The final date for payment could be identified by reference to the completion date, substantial completion, practical completion, the date of taking over or even the certificate of making good defects. There was nothing in the HGCR to prevent a construction contract from identifying a single final date for payment after completion of the works. The important point is that the event is objectively recognisable.

### Standard form contracts with a certifying regime

23. Before the HGCR came into force, it was not entirely easy to reconcile the somewhat rigidity of the requirement of the section 110(2) notice against the mechanisms and practices in respect of periodic monthly payments most frequently encountered in the construction industry. The JCT family of contracts have adopted the wording of the HGCR within the payment provisions, while the New Engineering and Construction Contract has adopted a slightly different approach. Under that form of contract the project manager's certificate is taken to be the payment notice, provided by the project manager on behalf of the employer, to the contractor.
24. The approach of the traditional JCT forms was that the architect or contract administrator was responsible for certifying an amount due, based upon a gross valuation of the work which was then subject to deduction for retention and sums already paid. The architect would most commonly ask the quantity surveyor to prepare the valuation, and quite often this was preceded by an application for payment from the contractor. So, despite the terms of contract, a contractor would prepare an application, clearly because it was in the contractor's interest to maximise the valuation and attempt to see that it was paid.
25. The contractor's application would then be "checked" by the quantity surveyor, who would adopt the amended application as his or her valuation before making a recommendation, most usually in writing, to the architect of the amount to be certified for payment to the contractor. The architect then issued the interim certificate, which in most cases will amount to the payment notice anticipated by section 110(2). However, the HGCR does not appear to make any provision for a failure to issue this payment notice.

### The section 110(2) payment notice

26. Duncan Wallace QC considered that the absence of any sanction for the failure to issue a section 110(2) payment notice was a significant lacuna in the legislation, which led him to question the legislative intention in requiring such a notice.<sup>10</sup> The absence of any sanction has also been commented upon by Lord MacFadyen in the case of *SL Timber Systems Limited v Carillion Construction Limited*<sup>11</sup>: "Section 111(1), unlike Section 110(2), did impose a sanction for failure to serve a notice"<sup>12</sup> and
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then again at paragraph 19:

“In my opinion the adjudicator fell into error in the first place by conflating his consideration of sections 110 and 111 of the 1996 Act. In my opinion Mr Howie was correct in his submission that these sections have different effects and the notices which they contemplate have different purposes. Section 110(2) prescribes a provision which every construction contract must contain. Section 110(3) deals with the case of a construction contract that does not contain the provision required by section 110(2) by making applicable in that case the relevant provision of the Scheme, namely paragraph 9 of Part II. By one or other of these routes every construction contract will require the giving of the sort of notice contemplated in section 110(2). But there the matter stops. Section 110 makes no provision as to the consequence of failure to give the notice it contemplates. For the purposes of the present case, the important point is that there is no provision that failure to give a section 110(2) notice has any effect on the right of the party who has so failed to dispute the claims of the other party. A section 110(2) notice may, if it complies with the requirements of section 111, serve as a section 111 notice (section 111(1)). But that does not alter the fact that failure to give a section 110(2) notice does not, in any way or to any extent, preclude dispute about the sum claimed. In so far, therefore, as the adjudicator lumped together the defenders’ failure to give a section 110(2) notice with their failure to give a timeous section 111 notice, I am of opinion that he fell into error. He ought properly to have held that their failure to give a section 110(2) notice was irrelevant to the question of the scope for dispute about the pursuer’s claims.”<sup>13</sup>

27. This is of interest as some had thought that the absence of a section 110(2) notice meant that the claimant (at least in an adjudication) was relieved of the usual burden of proving entitlement and should be awarded the sum claimed.

### The amount “due”

28. There was some confusion about precisely what the claiming party was entitled to if there was a dispute about payment, but in the context of a lack of notices. The position is exacerbated if the contract does not contain a certifying regime. Coulson describes the two extremes:

*“The most extreme position adopted by the payee was that, if it claimed £X under the contract, and there was no notice under s110(2) or no withholding notice from the payer in accordance with s111, it was said that the payee was entitled to £X. At the other extreme, it was said by the payer that a payment that was ‘due’ could only be identified as such following a detailed investigation by the adjudicator, and the court, as to whether the sums claimed were actually due. This, of course, would have allowed the payer a broad licence to investigate every element of the sum claimed, both in the adjudication and in court on the enforcement application, on the basis that, if it was not due, s110(2) could not apply.”<sup>14</sup>*

29. As Coulson notes, neither of these extreme positions has turned out to be correct.
30. One of the first decisions that considered that nature of a section 110(2) payment notice was *VHE Construction Plc v RBSTB Trust Co Ltd*<sup>15</sup>. RBSTB employed VHE Construction to carry out remediation work. The contract was a JCT Standard Form with Contractor’s Design, 1981 edition. That form of contract is somewhat different to the rest of the JCT family, in that clause 30.3.5 provides:

“Where the Employer does not give any written notice pursuant to clause 30.3.3 and/or to clause 30.3.4, the Employer shall pay the Contractor the amount stated in the Application for Interim Payment.”

10. Wallace, I.N.D. QC (2002) “The HGCR: A Critical Lacuna?” 18 (No 2) Const. LJ, 117.

11. [2001] BLR 516.

12. Paragraph 14.

13. Paragraph 19.

31. HHJ John Hicks QC reviewed these clauses, compared them to section 110(2), and stated at paragraph 33 of the judgment:

“I observe that section 110 operates by requiring there to be certain contractual provisions. There are default provisions which apply if the contract itself does not conform, but if (as here) it does so the statute, in an important sense, drops out of the picture. It is, however, necessary to have the terms of section 110 in mind when construing section 111.”

32. It seems that the provisions in the JCT with Contractor’s Design Edition 1998 goes somewhat further than the requirements of the HGCRA, in that failure of the employer to give a written notice means that the employer is then obliged to pay the contractor the amount of the contractor’s application, regardless of whether the amount of that application is a sum properly due under the contract. Section 110(1)(a) requires a mechanism that determines what payment become “due under the contract”, and arguably a contractor’s application might include items which are not properly due under the contract.

33. The case of *Northern Developments (Cumbria) Ltd v J&J Nichol*<sup>16</sup> was reported very shortly after *VHE Construction*. In *Northern Developments* HHJ Bowers QC referred to section 110 and stated:

“The only direct force of section 110 is to make the Scheme apply if the contract does not comply with the Act, and it was so effective in this case. But it also sets the context for section 111 which refers back to it.”<sup>17</sup>

34. He then goes on to state, at paragraph 29:

“The intention of the statute is clearly that if there is to be a dispute about the amount of the payment required by section 111, that dispute is to be mentioned in a notice of intention to withhold payment not later than 5 days after the due date for payment. Equally it is clear from the general scheme of the Act that this is a temporary arrangement which does not prevent the presentation of other set-offs, abatements, or indeed counterclaims at a later date by litigation, arbitration, or adjudication. For the temporary striking of balances which are contemplated by the Act, there is to be no dispute about any matter not raised in a notice of intention to withhold payment. Accordingly, in my view, the adjudicator had no jurisdiction to consider any matter not raised in the notice of intention to withhold payment in this case.”

35. There is of course some slight confusion in this passage, in that it is a section 110(2) notice that is to be given five days after the due date for payment, but clearly HHJ Bowers QC is referring to the operation of section 111 in respect of withholding notices. HHJ Bowers QC does go on to cite HHJ Hicks QC in *VHE Construction* noting that they agreed upon the effect of a withholding notice under the HGCRA.

36. Further, HHJ Bowers QC takes the view that if the paying party does not raise an issue in a withholding notice, then a dispute has not crystallised. If there is no dispute, then there is nothing to refer to an adjudicator, and so an adjudicator would not have any jurisdiction in the first place.

37. Some have interpreted *Northern Developments* as supporting the proposition that any dispute about payment raised by the paying party had to be included within the withholding notice otherwise it could not be dealt with by the adjudicator at all. This interpretation misses the distinction between a contract that contains a certifying regime and one that does not, and also the crucial question of whether a sum claimed was not due at all in the first place.

38. If there is a certifying regime within the contract then the paying party

14. HHJ Peter Coulson QC, *Construction Adjudication*, paragraph 2.128.

15. [2000] BLR 187.

16. [2000] BLR 158.

17. Page 163 at paragraph 27.



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will be hard pressed in an adjudication to argue that an amount certified should not be paid in the absence of a withholding notice. However, in the absence of any certificates it must be open to the paying party to demonstrate that a sum claimed is not in fact due at all. In principle, the distinction between a payment notice and a withholding notice was further developed in the case law, but the clearest explanation was provided by Lord MacFadyen in *S L Timber Systems Ltd v Carillion Construction Ltd*<sup>18</sup>. This is further considered below, after a brief consideration of the section 111 withholding notices.

## The Section 111 Withholding Notice

39. It is of course difficult to escape consideration of the nature of the section 110 notice, without referring to the perhaps more important section 111 withholding notice. Section 111 is set out as follows:

- (i) A party to a construction contract may not withhold payment after the final date for payment of a sum due under the contract unless he has given an effective notice of intention to withhold payment.

The notice mentioned in section 110(2) may suffice as a notice of intention to withhold payment if it complies with the requirements of this section.

- (ii) To be effective such a notice must specify -

- (a) the amount proposed to be withheld and the ground for withholding payment, or
- (b) if there is more than one ground, each ground and the amount attributable to it,

and must be given not later than the prescribed period before the final date for payment.

- (iii) The parties are free to agree what that prescribed period is to be.

In the absence of such agreement, the period shall be that provided by the Scheme for Construction Contracts.

- (iv) Where an effective notice of intention to withhold payment is given, but on the matter being referred to adjudication it is decided that the whole or part of the amount should be paid, the decision shall be construed as requiring payment not later than -

- (a) seven days from the date of the decision, or
- (b) the date which apart from the notice would have been the final date for payment,

whichever is the later.

40. The distinction between a payment notice and a withholding notice was again referred to by HHJ Gilliland QC in the case of *Millers Specialist Joinery Company Ltd v Nobles Construction Ltd*<sup>19</sup> where he states at paragraph 15:

“The notices under the two sections are however directed to different aspects of a payment. Under S.110 the act is directed to making clear what is being paid and how that sum has been calculated, whereas under S.111 the notice is directed to the amount which is being withheld and the reasons for withholding payment.”

18. [2001] BLR 516.

41. While then the section 110(2) payment notice is concerned with the

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valuation of work done, section 111 is concerned with contra-charges arising under the contract or other claims arising out of other contracts which are being claimed by way of set-off against the contract in question. *Keating on Building Contracts*<sup>20</sup>, appears to consider that a purposive construction of the section demands that a withholding notice is required for any cross-claim whatsoever, and in the absence of a withholding notice the claimant should be paid the sum claimed:

“There has been some debate as to the precise meaning and effect of this section [section 111]. The problem arises because the section envisages that there is a “sum due under the contract”. An equitable set-off amounts to a discharge of the sum due, to the extent of the set-off, and a common law abatement denies that moneys are due or owing. Thus, it is said, that there is no sum due in those two instances and no need to serve the relevant notice. This would appear to leave the section largely devoid of content. It is submitted that a court would construe the section in a purposive manner to meet the mischief intended, so that, in the absence of notice, the payee would be entitled to claim payment, ignoring any set-off or abatement.”

42. In respect of this point HHJ Bowsher QC, in *Whiteways Contractors (Sussex) Limited v Impresa Castelli Construction UK Limited*<sup>21</sup> said at paragraph 32:

“It is common for a party to a building contract to make deductions from sums claimed on the Final Account (or on earlier interim applications) on account of overpayments on previous applications and it makes no difference whether those deductions are by way of set-off or abatement. The scheme of the HGCR is to provide that, for the temporary purposes of the Act, notice of such deductions is to be made in manner complying with the requirements of the Act. In making that requirement, the Act makes no distinction between set-offs and abatements. I see no reason why it should have done so, and I am not tempted to try to strain the language of the Act to find some fine distinction between its applicability to abatements as opposed to set-offs. Of course, in considering a dispute, an adjudicator will make his own valuation of the claim before him and in doing so, he may abate the claim in respects not mentioned in the notice of intention to withhold payment. But he ought not to look into abatements outside the four corners of the claim unless they have been mentioned in a notice of intention to withhold payment.”

43. HHJ Bowsher QC considers that there is no difference between set-off and abatement for the purposes of considering the effect of the notices. However, when an adjudicator carries out his own valuation he may reduce (abate) the amount claimed in respect of items that are not properly “due under the contract” even though they are not specifically mentioned in the section 111(1) withholding notice. This is of course because both a section 110 and section 111 notice relate to “sums due under the contract” and if an item is not properly due under the contract in question then an adjudicator can still abate the sum claimed, but only in respect of elements making up the claim. So, if the claim includes 400m<sup>2</sup> of brickwork and 50m<sup>2</sup> are defective, then the adjudicator can base his decision on an amount in respect of 350m<sup>2</sup> even in the absence of a section 111 notice.<sup>22</sup>
44. In *S L Timber* Lord MacFadyen made the important distinction between a “sum claimed” and a “sum due under the contract”:

“The more significant issue in the present case, in my opinion, is whether the defenders’ failure to give a timeous notice under section 111 had the effect that there could be no dispute at all before the adjudicator as to whether the sums claimed by the pursuers were payable. The section provides that a party “may not withhold payment after the final date for payment of a sum due under the contract unless he has given an effective notice of intention to

19. [2001] CILL (September) 1770-1773.

20. 8th Edition, paragraph 17-055.

21. 9 August 2000, unreported.

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withhold payment”. In my opinion the words “sum due under the contract” cannot be equated with the words “sum claimed”. The section is not, in my opinion, concerned with every refusal on the part of one party to pay a sum claimed by the other. It is concerned, rather, with the situation where a sum is due under the contract, and the party by whom that sum is due seeks to withhold payment on some separate ground. Much of the discussion of the section in the cases has been concerned with what circumstances involve “withholding” payment and therefore require a notice. Without the benefit of authority I would have been inclined to say that a dispute about whether the work in respect of which the claim was made had been done, or about whether it was properly measured or valued, or about whether some other event on which a contractual liability to make payment depended had occurred, went to the question of whether the sum claimed was due under the contract, therefore did not involve an attempt to “withhold a sum due under the contract”, and therefore did not require the giving of a notice of intention to withhold payment. On the other hand, where there was no dispute that the work had been done and was correctly measured and valued, or that the other relevant event had occurred, but the party from whom the payment was claimed wished to advance some separate ground for withholding the payment, such as a right of retention in respect of a counterclaim, that would constitute an attempt to “withhold...a sum due under the contract”, and would require a notice of intention to withhold payment.”<sup>23</sup> (Emphasis added)

45. The important point is that a “sum claimed” is distinct from a “sum due”, and so once a sum is due under the contract a withholding notice is required in order that the payer can reduce the amount of the payment of the sum due. He then sets out some examples of cross-claims that might not require a withholding notice if the dispute focused on whether the sum claimed was due under the contract.
46. Importantly, Lord MacFadyen considered that failure to serve a valid withholding notice did not relieve the claimant of the ordinary burden of proving that he should be awarded the sum claimed. This merely confirms the ordinary burden of proof - that he who asserts must prove on the balance of probabilities - and so one then turns to the words in the contract in order to ascertain that which is due. In respect of a failure to serve a valid section 111 withholding notice Lord MacFadyen stated:

*“In my opinion, the absence of a timeous notice of intention to withhold payment does not relieve the party making the claim of the ordinary burden of showing that he is entitled under the contract to receive the payment he claims. It remains incumbent on the claimant to demonstrate, if the point is disputed, that the sum claimed is contractually due. If he can do that, he is protected, by the absence of a section 111 notice, from any attempt on the part of the other party to withhold all or part of the sum which is due on the basis that some separate ground justifying that course exists.”<sup>24</sup>*

22. A related question here is the extent of the adjudicator's jurisdiction derived from the wording of the notice of adjudication. If the notice of adjudication simply questions whether a specified amount of money should be paid in respect of the 400m<sup>2</sup> of brickwork (a “narrow” notice) then the adjudicator can only award that sum or decide that nothing is due. If, however, the notice is wider in that it asks what sum should be paid in respect of the brickwork then arguably the adjudicator has the jurisdiction to conclude that some part of the total claim is defective or absent and so come to a conclusion about what amount, if any, should be paid. Ironically, in this example, if the adjudicator under a “narrow” notice comes to the correct conclusion that only 350m<sup>2</sup> should be paid his decision would not be enforced because he did not have the jurisdiction to come to that decision. While under a “what sum is due” notice the adjudicator could apply entirely the wrong approach coming to the *wrong* decision but nonetheless it would still be enforced.

47. The adjudicator, in *S L Timber*, was concerned that the HGCR would be ineffective if he were able to ignore the failure of the defendants to serve a withholding notice and take the defendant's cross-claims into account. Those concerns failed to consider the distinction between abatement within the scope of the claim (which did not need a withholding notice) and other cross-claims such as an equitable set-off for liquidated damages, which would need to be referred to in a timeous withholding notice. If the claimant can show what he is due under the contract then the defendant must serve a withholding notice in respect of those matters for which he does not intend to pay. In the absence of a withholding notice (but dependent on the terms of the contract) a defendant can still argue that a sum is not due under the contract, and included within that category is abatement for defective works.

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48. In *S L Timber*, Lord MacFadyen came to the conclusion that the adjudicator's view as to how section 111 operated was wrong. However, that error was in answer to the adjudicator asking himself the right question, and so the decision was enforced on the frequently cited expert determination rationale:

“Error of fact or law on the part of the adjudicator will not afford ground for refusal of enforcement, unless the error was of such a nature that the adjudicator's decision was, as a result, one which he had no jurisdiction to make.”<sup>25</sup>

49. The error was one that the adjudicator had the power to make. The error was *intra vires*, rather than rendering the decision *ultra vires*.
50. Nonetheless, Lord McFadyen's analysis makes it clear that where there is a dispute about the “sum due” under a contract then an adjudicator, arbitrator or judge need to consider what sum was actually due, rather than simply considering whether appropriate notices have or have not been issued. HHJ Bowsher's approach in *Northern Developments* would mean that there could be no dispute between the parties as the matter would simply be answered by considering to the notices, or perhaps the lack of them.

### The approach under a “certifying” contract

51. Sheriff Taylor in *Clark Contracts Ltd v The Burrell Co (Construction Management) Ltd*<sup>26</sup> made a distinction between a claim based on simply an application for payment as opposed to one based upon a valuation or certification process in a contract. In *Clark* the main contractor's claim was based on a dispute relating to the interim certificate. The main contractor did not agree with the amount in the interim certificate, however Sheriff Taylor concluded that there was no dispute that the architect had in fact issued an interim certificate which appeared to amount to a notice under section 110(2) of the HGCRA. The contractor became entitled to payment within 14 days of the certificate being issued. As a result, if the employer wished to pay a lesser amount, then the employer had to issue a withholding notice in accordance with section 111(1) of the HGCRA. In *Clark* the employer had failed to issue a section 111(1) notice and therefore the sum was undisputedly due.
52. *Rupert Morgan Building Services Ltd v David Jervis & Harriett Jervis*<sup>27</sup> is a brief but important case from the Court of Appeal concerning the meaning of section 111 of the HGCRA. Jervis withheld payment of part of an interim certificate, but failed to issue a withholding notice as prescribed by the HGCRA. The defendants said that it was open to them to prove that items of work that went to make up the unpaid balance were not done, were duplicated or represented snagging for work that had already been paid for.
53. The Court of Appeal considered two conflicting interpretations as to the true meaning of section 111(1) of the HGCRA, namely the “narrow” and the “wide” approach. The narrow construction, represented by Jervis, was to the effect that if work had not been done, there can be no “sum due under the contract” and, accordingly, section 111(1) does not apply.<sup>28</sup> The wider construction submitted by Rupert Morgan was that work not done cannot affect the due date but that section 111(1) of the HGCRA applies and, in absence of a timeous withholding notice, the certified sum must be paid.<sup>29</sup>
54. The Court of Appeal preferred the wider construction. The Court found that the parliamentary aim of section 111(1) of the HGCRA was not simply

23. Paragraph 20.

24. Paragraph 22.

25. Paragraph 18.

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to safeguard quick payment to the contractor if ordered so in the adjudication decision. Lord Justice Jacob emphasised that the “fundamental thing to understand is that section 111(1) is a provision about cash flow”, i.e. in the absence of a withholding notice it operates to prevent the employer withholding the sum due under the contract, and to maintain cash flow for the contractor.

55. According to the wider construction, rights to retain money or to set-off do not serve as a defence against enforcement. An employer who fails to give a timeous withholding notice has to pay the money awarded by the adjudicator first, and can reclaim any overpayment later by way of a further adjudication or, if necessary, by way of arbitration or litigation. Thus, section 111(1) of the HGCRA does not affect but only defers existing contractual rights to withhold payment to subsequent proceedings.
56. The wider interpretation fits well with the “pay now, argue later” public policy of the HGCRA. However, a principal disadvantage of the wider construction from the paying party’s point of view is that if it has overpaid it is at risk of insolvency of the contractor. Nonetheless, it may be possible to obtain a stay of execution if the receiving party is in serious financial difficulties and the paying party has taken immediate steps to resolve its counterclaim.<sup>30</sup> The Court acknowledged this mischief but held the risk is one which can be avoided by checking the certificate and giving a timeous withholding notice. Besides, the Court of Appeal indicated that an architect’s (or engineer’s) duty might extend to ensuring that a lay employer was aware of the possibility of serving a withholding notice in sufficient detail and good time.
57. Although Lord Justice Jacob made reference to the numerous authorities on this question, he felt that they concentrated on the “*unspoken but mistaken assumption that the provision is dealing with the ultimate position between the parties*”. He turned to the actual contract in question, which was in the standard form provided by the Architecture and Surveying Institute. Clause 6.33 said that “the Employer shall pay the Contractor the amount certified within 14 days of the date of the certificate, subject to any deductions and set-offs due under the Contract”. Thus it was not the amount of work done that defined the sum which was due but the sum stated in the certificate. Lord Justice Jacob continued:

“In the absence of a withholding notice, s.111(1) operates to prevent the client withholding the sum due. The contractor is entitled to the money right away. The fundamental thing to understand is that s.111(1) is a provision about cash flow. It is not a provision which seeks to make any certificate, interim or final, conclusive.”

58. If, as in *SL Timber v Carillion Construction*, the contract did not provide for a system of certificates and a contractor simply presented an application for payment then that application would not necessarily identify the amount properly due. Therefore, a withholding notice would not be necessary in respect of work not done as payment would not be due in the first place. Lord Justice Jacob set out the following five advantages of this approach:

- (a) It draws a line between claims for set-off which do no more than reduce the sum due and claims which go further such as abatement;
- (b) It provides a fair solution that safeguards cash flow but does not prevent a party from raising disputed items in adjudication or litigation;

26. [2002] SLT 103.

27. [2003] EWCA Civ 1563.

28. Cf. *Woods v Hardwicke* [2001] BLR 23; (arguably) *VHE Construction Ltd v RBSTB Trust Ltd* [2000] BLR 187 and *SL Timber Systems Ltd v Carillion Construction Ltd* [2001] BLR 5160

29. Cf. *Whiteways Contractors (Sussex) Ltd v Impresa Castelli Construction UK Ltd* [2000] 16 CLR 453; *Millers Specialist Joinery v Nobles*, available on [www.adjudication.org](http://www.adjudication.org); *Levolux AT Limited v Ferson Contractors Limited* [2003] CILL Letter 2003, p.1956 and *Keating on Building Contracts* (8th Edition, para 17-055.

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- (c) It requires the client who is going to withhold to be specific in his notice about how much he is withholding and why. This limits the amount of withholding to specific points, which must be raised early;
  - (d) It does not preclude the client who has paid from subsequently showing he has overpaid. If he has overpaid on an interim certificate the matter can be put right in subsequent certificates. Otherwise he can raise the matter by way of adjudication, or if necessary, arbitration or legal proceedings; and
  - (e) It is directed at the mischief which section 111(1) was aimed at - namely, payment (or non-payment) abuses.
59. It was conceded that the main disadvantage was the risk of insolvency. However, as the Court of Appeal said, that risk can be minimised if certificates are carefully checked and any withholding notice is given within time.
60. Interestingly, Lord Justice Jacob identified the possibility that there may be a duty on architects (and presumably other contract administrators) to ensure that a lay client is aware of the possibility of serving a notice in sufficient detail and good time. Given the clarity of this Court of Appeal ruling, even if there is no legal responsibility for failing to advise this, it is surely good practice even if the client has some experience of the construction industry.
61. *Rupert Morgan* has gone some way to clarifying the position where no withholding notice has been given. Thus, where an interim certificate has been issued, the absence of a notice in accordance with section 111 of the HGCRA, will mean that it is not permissible to withhold from the payment due (in respect of items of work already paid for or work not in fact carried out). The issue here related to interim certificates. A party will not be left without a remedy as the matters can be rectified by way of issue of the next interim certificate or even the final certificate. With a final certificate the situation may be different and a party will commence litigation or arbitration to cover any overpayment.

### Withholding against an adjudicator's decision

62. If an adjudicator has made a decision about an interim valuation then the question arises as to the status of that decision at the subsequent valuation. If an adjudicator's decision is binding, any amount awarded must be paid, so what is the effect of the detail of that decision upon the valuation process at subsequent valuations? Under the terms of the standard forms and most bespoke construction contracts interim valuations are simply a payment towards the lump sum total of the contract. Importantly, each interim valuation is calculated gross based upon the work carried out and the current issues relating to the works. Arguably an interim valuation carried out is subsequent to an adjudicator's decision should entitle the valuer to value the works gross and the binding extent of an adjudicator's decision can only really extend any particular matters decided by the adjudicator in respect of valuation, principle, unit rate, etc.
63. Further, final account procedures will no doubt require a detailed review of the valuation of the works, which will no doubt provide further opportunity to review the value of the works, which may raise issues as to matters considered by an adjudicator.
64. The Court of Appeal has made it clear that an adjudicator's decision which is made *intra vires* is enforceable regardless of any error of law or

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30. The effect of the contractual payment machinery has been illustrated in the case of *Shimizu Europe Limited v LBJ Fabrications Limited* (29 May 2003, CILL, 2015 et seq.) In this case, the contractual payment machinery required the issue of an invoice in order to trigger a period of time leading to the final date for payment. Thus, it was held possible by the TCC to serve a valid withholding notice before the final date for payment of the adjudicator's decision which will be effective against the adjudicator's decision.

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fact. If then an adjudicator's decision simply requires the payment of some amount of money, without any reasons, then once that amount has been paid the paying party must arguably be free to apply contentious arguments on future valuations or indeed the final account. The situation may of course be different where an adjudicator has come to a specific conclusion about a matter relating to valuation principle etc.

65. This is the situation that has arisen in Australia under the New South Wales adjudication legislation.<sup>31</sup> John Holland Pty Ltd ("John Holland") and the Roads and Traffic Authority of New South Wales ("RTA") entered into a contract to construct a roadway and associated bridgeworks (the "Contract"). The terms of the Contract provided for security "for the purposes of ensuring the due and proper performance of the Contract and of satisfying the obligations of the Contractor under the Contract."
66. In the course of the works adjudications were brought by John Holland and the adjudicator awarded amounts well in excess of the amount of security to be paid by RTA to John Holland. RTA paid these amounts.
67. After the works reached practical completion John Holland asked for the RTA to return half the security and the RTA declined. By this stage, disputes had arisen between the parties whereby RTA sought to recover the amounts paid to John Holland.
68. John Holland brought proceedings for the return of half of the security. John Holland argued that to the extent that the Contract's provisions sought to undo the adjudicators' determination, they were void by reason of the Act. At first instance, the judge decided that the RTA was entitled to retain the securities. John Holland appealed.
69. It was decided that the RTA was entitled to retain John Holland's securities. The Contractual terms providing for the security to be retained to satisfy any obligation that John Holland might ultimately have to pay the RTA were not contrary to the operation of the Act. As an adjudicator's decision is interim, it is subject to a different position being established in relation to payment for the relevant work or related goods or services, either contractually or in proceedings. The Contractual mechanisms for working out the parties' rights under the contract still operated, and had to be followed. The adjudicated claims were only part of the contractual tapestry. It was not correct that the retention of security "undoes" an adjudicator's determination, or that a superintendent who in performing his contractual function came to a determination negates a statutory right to retain an adjudicated amount. The adjudicator's determination remains, and brings payment of the adjudicated amount, but that is interim and subject to a different position being established in relation to payment for the relevant work or related goods and services, contractually or in proceedings.
70. While then it is not possible in the UK to set-off against an adjudicator's decision, a decision simply requiring a payment of money may be open to reconsideration and withholding in respect of the valuation of the works.

### Status of an adjudicator's decision

71. A related question is the status of an adjudicator's decision. Is the decision not enforceable in its own right, because it is in fact the contractual obligations to comply with the decision of being enforced or is the decision forcible in its own right, in the same way as an arbitration award is enforced? However, an arbitration award is enforced because the Arbitration Act 1996 provides that it should be enforced as if it were a judgment of the court. An adjudicator's decision is grounded upon the

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31. The *Building and Construction Industry Security of Payment Act 1999* (NSW).

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contract between the parties so must be susceptible to subsequent valuation machinery within the contract.<sup>32</sup>

## The timing of the notices

72. *Strathmore Building Services v Colin Scott Grieg (trading as Hestia Far Side Design)*<sup>33</sup> the paying party had failed to issue a section 111(2) withholding notice. However, in a telephone conversation which took place before the payment was even due, issues were raised by the paying party. The issue, therefore, was whether a section 111(1) notice has to be in writing. The HGCR does not specifically state that it has to be in writing, nor whether such an oral notice can be given before the date of the relevant application for payment.
73. Lord Hamilton in the Court of Session said that section 111 notice quite clearly had to be given in writing and must be given at the relevant time. A section 111 notice could not be given “early”. It had to fall within the applicable payment mechanics of the contract or the HGCR as the issue of the notice was either a response to an application for payment or served to identify a reduction in the section 110 notice.
74. Further, as a section 111 notice required the ground or grounds together with each amount to be identified these ground or grounds could only relate to the application or certificate. It was therefore not possible to issue an effective notice prior to receipt of the application for payment nor a certificate or a section 110 notice.
75. This is not the only case relating to technical arguments about the early service of a section 111 notice. If a withholding notice is not issued before the requisition period before the final date for payment then it is ineffective.<sup>34</sup> However, care is needed and particular reference to the terms on the contract must be considered. So, for example where the final date for payment was 28 days after receipt by the paying party of an invoice then a withholding notice issued within the requisite period for the final date for payment was valid.<sup>35</sup>
76. In *Shimizu Europe Limited v LBJ Fabrications Limited*<sup>36</sup> Shimizu, as main contractor for work at plot 10, Edmund Halley Road, Oxford Science Park, engaged LBJ as subcontractors for the design, supply and installation of the louvres and cladding. A contract was recorded in a Letter of Intent dated 14 February 2002, which stated that the contract would be in the form of the DOM/1 together with various non-standard amendments.
77. LBJ made an application for an interim payment which became the subject of an adjudication. The parties agreed to adjudicate in accordance with the TeCSA Adjudication Rules 1999 version 1.3. The adjudicator’s decision was dated 20 February 2003 in which he valued LBJ’s work and decided that Shimizu should pay the sum of £47,718.39 plus VAT as appropriate “without set-off. Payment to be made not later than 28 days after LBJ had delivered a VAT invoice as required by amended clause 21.2.4”.
78. Shimizu reserved their position during the adjudication and refused to pay. They sought a declaration in which they challenged the adjudicator’s jurisdiction and also challenged the decision on the basis of breaches of natural justice.
79. Once a decision had been issued, LBJ sent an invoice to Shimizu. Shimizu then served a withholding notice in relation to sums due in respect of that invoice.

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32. For a more detailed decision see Gould, N. “The Status of an Adjudicator’s Decision: Does it create a cause of action in its own right?” (2005) 21 CLJ 6.

33. [2001] 17 Const LJ 72.



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80. Shimizu argued that by virtue of clause 21.2.4 a payment did not become due to the subcontractor until Shimizu had submitted an invoice. The final date for payment was 28 days after submission of that invoice. The adjudicator decided that an amount was due, but the final date for payment was 28 days after receipt of the invoice. Shimizu argued that they were therefore able to serve a withholding notice not later than 5 days before that final date for payment. Shimizu also argued that the adjudicator based his decision on the wrong contract.
81. HHJ Kirkham held that the TeCSA Rules provided that the adjudicator could determine his own jurisdiction. He was therefore able to determine the basis of the contract from which the dispute arose. His decision was made within jurisdiction. He was able to determine the amount payable as at the date of his decision. However, he could not take into account set-off that might arise in the future. It was therefore possible for Shimizu to issue a withholding notice in respect of set-offs which arose after the date of the adjudicator's decision, but before the final date for payment. Therefore Shimizu's withholding notice was effective and Shimizu were not obliged to pay the adjudicator's decision. She accepted that it was a harsh position, but the HGCRA did not prohibit this approach, which was simply an application of the terms of the sub-contract agreed between the parties.
82. *Reinwood Limited v L Brown & Sons Limited*<sup>37</sup> was an appeal by the contractor, L Brown against a Court of Appeal decision which had held that Brown had not been entitled to determine a contract (JCT Standard Form 1998 edition) between it and the respondent employer, Reinwood, on the basis that Reinwood had unfairly withheld a sum which was due under the contract. There was a specified completion date under the contract as well as provisions for extensions of time, damages for non-completion and the right of the contractor to determine the contract on certain specified defaults by the employer.
83. Brown applied for an Extension of Time ("EOT") in December 2005. The architect issued a certificate of non-completion and an interim certificate for payment in which the final date for payment was 26 January 2006. On 17 January, Reinwood issued a withholding notice based on the LADs resulting from the issue of the Certificate of Non-Completion, and paid the remainder of the certificate on 20 January.
84. On 23 January the architect issued an EOT. The following day Brown ordered Reinwood to pay the outstanding balance of the payment certificate by the final date for payment. Reinwood did not pay by the due date and citing this as a specified default under the contract Brown determined its employment. Brown submitted that Reinwood was entitled to rely on the Certificate of Non-Completion at the time it served the withholding notice. However, Reinwood had lost that entitlement by the final date for payment since it could no longer rely on the Certificate of Non-Completion as a basis for withholding payment from Brown.
85. The Court of Appeal held that Reinwood's right to LADs crystallised at the time of the withholding notice thus upholding its right to levy LADs. The effect of the EOT meant that the balance of the damages properly due to Brown should be paid in a reasonable time though not by the final date for payment. Brown appealed to the House of Lords.
86. The House of Lords dismissed the appeal.
87. Reinwood as employer, was entitled to deduct LADs specified in the notice of Non-Completion from the amount stated to be due in the

34. See for example *Ferson Contracts Limited v Levloux* [2002] EWCA Civ 11; *The Construction Centre Group Limited v Highland Council* [2002] BLR 476; *Bovis Lend Lease Limited v Triangle Developments Limited* [2003] BLR 31; *VHE Construction Ltd v RBSTB Trust Co Ltd* [2000] BLR 187.

35. See HHJ Kirkham's decision in *Shimizu Europe Limited v LBJ Fabrications Limited* [2003] BLR 381.

36. [2003] BLR 381.

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Interim Certificate. The withholding notice was effective when it was given because the architect had not yet issued a certificate fixing a new completion date. The EOT granted by the architect on 23 January could not retrospectively alter the fact that the employer had, on 20 January, paid the sum then properly payable by it. But an employer in this situation is obliged to pay or repay any LADs that were recovered, allowed or paid after he has been informed by the architect of the fixing of a new completion date. This must be done within a reasonable time after receipt of that information.

88. If the EOT had been granted before 11 January, Reinwood would not have been entitled to deduct the LADs. It follows that where the necessary preconditions are satisfied and an employer has served a withholding notice, both parties are entitled to proceed on the basis that payment will, and can properly, be made in accordance with the notice. This was reinforced by the fact that part of the purpose of the notices required by sections 110 and 111 was to enable parties to a construction contract to know where they stand.
89. Similarly, in *Avoncroft Construction Limited v Sharba Homes (CN) Limited*,<sup>38</sup> the claimant, Sharba Homes (CN) Ltd, engaged the defendant, Avoncroft Construction Ltd, in September 2006 on the JCT 1998 Private Without Quantities contract. When a dispute arose and the matter was referred to adjudication, the adjudicator awarded the claimant £56,380. The defendant refused to pay and the claimant applied for summary judgment. The defendant resisted the application on the ground that it was entitled to set-off LADs against the sum awarded.
90. The claimant argued that as the contract lacked a provision for sectional completion, and the defendant took partial possession, there was no underlying entitlement to LADs as the clause failed according to the principle in *Bramall & Ogden v Sheffield City Council*.<sup>39</sup> The defendant disagreed that this principle applied as usually circumstances arose when the claimant barricaded a show room and prevented access when payment was not received. It was submitted that partial possession was frustrated by the actions of the claimant. HHJ Kirkham was not persuaded by this and held that 'it is a question of law whether, partial possession having been obtained, LADs are payable at all'.
91. On the question as to whether the defendant was entitled to set off its claim for LADs against the sum due pursuant to the decision of the adjudicator, HHJ Kirkham, at paragraph 9, referred to the guidance Jackson J gave in *Balfour Beatty Construction Ltd v Serco Ltd*:<sup>40</sup>
  - (i) Where it follows logically from an adjudicator's decision that the employer is entitled to recover a specific sum by way of liquidated and ascertained damages, the employer may set off that sum against monies payable to the contractor pursuant to the adjudicator's decision.
  - (ii) Where the entitlement to liquidated and ascertained damages has not been determined either expressly or impliedly by the adjudicator's decision, then the question whether the employer is entitled to set-off will depend upon the terms of the contract and the circumstances of the case."
92. When applying Jackson J's guidelines, HHJ Kirkham held that the defendant was not entitled to set-off any LADs due. The adjudicator did not decide the question of entitlement to LADs, as it was not argued, and there was not an express provision in the contract entitling the defendant

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37. [2008] UKHL 12, 20 February 2008, House of Lords, Lord Hope of Craighead, Lord Scott of Foscote, Lord Walker of Gestingthorpe, Lord Brown of Eaton-under Heywood, Lord Neuberger of Abbotsbury.

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to deduct and withhold LADs.

93. HHJ Kirkham further considered, albeit obiter, the validity of a withholding notice. As the contract did not provide for service of a withholding notice against the decision of an adjudicator, she referred to section 111(3) of the HGCR Act 1996 and held that Part 2 of the Scheme would therefore apply. Accordingly, the notice had been served one day late. The defendant argued that it would have been impossible to serve the notice on time as the adjudicator's decision was released exactly seven days before payment was due. They argued that the Court should recognise this impossibility and an allowance should be made. She rejected this submission and upheld the general approach of the courts which is to strictly comply with the time limits provided by the HGCR Act.
94. HHJ Kirkham further rejected the application for a stay and the application for an order that the defendant pay the judgment sum into Court. She was not persuaded by the defendant's argument that the claimant would probably be unable to repay the judgment sum and that there are special circumstances within the meaning of RSC Order 47 Rule 1. Equally, applying the decision in *Interserve Industrial Services Ltd v Cleveland Bridge UK Ltd*,<sup>41</sup> she rejected the defendant's application for a stay as they wished to await the outcome of a second adjudication which was due in two weeks' time.

### The "grounds" for withholding

95. The grounds for withholding each amount can be put simply, and there is no need for extended detail. The HGCR Act simply requires identification of the ground or grounds, and providing that a party serving a withholding notice complies with that simple requirement the notice will be valid.
96. In *Thomas Vale Construction PLC v Brookside Syston Limited*<sup>42</sup> the claimant, Thomas Vale, sought a declaration that a withholding notice was invalid. The contract was a JCT Standard Form of Building Contract with Contractor's Design 1998 Edition incorporating Amendments 1-5 and further amendments set out in the Employer's Requirements. The works comprised the construction of 24 apartments. A dispute arose as to the date of completion, and both parties made claims against each other. Cross-adjudications were commenced. In April 2006, the parties resolved some of their differences in a written supplemental agreement. Clause 7 provided:

"Neither party shall be obliged to make any payment to the other, whether by way of payment for the Works, damages for late completion or the release of retention until such time as the Final Account is either agreed between the parties or determined pursuant to the Building Contract."
97. The supplemental agreement also provided for an expert to determine the date for practical completion and the outstanding snagging works. The appointed expert concluded that practical completion was achieved on 22 May 2006, and that there were over 600 snagging items. The final account was progressed, but was not agreed. An adjudicator determined the amount of the final account. Irrespective of a claim for a final payment Brookside issued a withholding notice.
98. The issue was whether the final account should now be paid, and whether the withholding notice was valid.
99. Her Honour held that on the true construction of the contract (in other words the building contract and the supplemental agreement read together) the parties had not agreed that payment would become due as

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38. [2008] EWHC 933, TCC, 29 April 2008, HHJ Frances Kirkham.

39. (1983) 29 BLR 73.

40. [2004] EWHC 3336 at paragraph 53.

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soon as the final account had been determined. Clause 30.5 of the original contract dealt with the final account. It provided that the final account and final statement were due at the latest of either the end of the defects liability period, the day named in the notice of completion and making good defects, or the date of submission of the final account. The supplemental agreement did not amend these terms, and the latest of those three events had not yet occurred. Payment was therefore not due.

100. Nonetheless, the contractor was entitled to make an application for payment under Clause 30.3.5 and Brookside was entitled to serve a withholding notice. Four arguments were raised in connection with the withholding notice:
- (i) The grounds for the withholding notice were Thomas Vale's failure to use reasonable endeavours to remedy the defects, but the damages were calculated on the basis of engaging others to carry out the work. Her Honour rejected the distinction, on the basis that it was inappropriate to "*apply fine textural analyses to a notice which is intended to communicate to the other party why a payment is not to be made*".<sup>43</sup>
  - (ii) The notice contained a small number of items that were not contained within the expert's snagging items. Her Honour concluded that a small number of "de-minimus" items would not invalidate a notice.
  - (iii) The contractor argued that the final account procedure determined the amounts paid, so any deductions should have been raised during that process. It was not open to the employer now to set-off against the final account once that process had been concluded. Her Honour held that the determination of the final account did not trigger an obligation to make a payment, and therefore the employer could serve a withholding notice providing it was served within the timescales of the contract.
  - (iv) Finally, Thomas Vale argued that the employer was in effect attempting to set-off a disputed and liquidated counterclaim against a sum found to be due by an adjudicator. Her Honour rejected that argument. The adjudicator determined the final account amount, but did not identify a precise payment that was to be made. Further, the expert had found that there were many snagging items, and the contractor had not completed those items. Clearly it would be inequitable to make a payment that disregarded the failure of the builder to carry out the defects work that had been identified by the expert.
101. Thomas Vale was therefore not entitled to a declaration that the withholding notice was invalid.
102. In *Aedas Architects Limited v Skanska Construction UK Limited*,<sup>44</sup> the dispute arose out of works done on contracts to renovate several schools in Midlothian. The Pursuer sought periodical payments but was met with refusal as the Defender claimed that it had large and on-going contra set-offs which were much more than what the claimant was pursuing.
103. The Pursuer argued that where monies are withheld, the notice ("counter-notice") must specify an amount, grounds and then an attribution to each ground in order to be effective under section 111 of the HGCR. He claimed that although the Defender had issued counter-notices, none of them were effective. However, the Defender argued

41. [2006] EWHC 741 (TCC).

42. [2006] EWHC 3637 (TCC), 14 November 2006, TCC, HHJ Kirkham.

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that the counter-notices should not be subjected to a fine, textual analysis. They were not addressed to lawyers, but rather contract managers and others who were aware of what was happening on site in an ongoing contract concerning several places. The Defender claimed that the grounds and amounts had been specified and that was therefore enough.

104. The issue before Lord McEwan was whether or not the counter-notices specified in sufficient detail, the grounds for set-off. Lord McEwan accepted that Melville Dundas does “stress the need for clarity when interim payments are withheld. That is set against the background of the machinery of adjudication. Section 111 of the HGCRA is also intended to reduce “set-off abuse” and promote confidence in “cash flow”. He stated that both *Melville Dundas and Reinwood Ltd v Brown & Sons Ltd* reinforce that, for interim payments, parties should know in advance where they stand.
105. Lord McEwan appreciated the problem, which was presented to both sides. The Pursuer wished the clarity demanded by the HGCRA, and the Defender, who said that they had a substantial and on-going set-off, did not want to part with any money: “*In any commercial matter there is always the risk of insolvency or delays and cash flow difficulties.*”<sup>45</sup>
106. Given that this was an issue of summary decree, the judge applied the test formulated by the House of Lords in *Henderson v Nova Scotia Limited* 2006 SC (HL) 85, and was unable to say that the defence was bound to fail. He did not think that the matter could be properly disposed of, only on the evidence of counter-notices. Issues of fact could arise and this would allow evidence of meetings and conversations to explain the letters and the events surrounding the notices. In any event, it was held that the documents themselves were effective under section 111. Sufficient detail had been set out in respect of the five grounds. That in itself was enough to find that it cannot be said that the defence was bound to fail.

## Interaction with the contract

107. The interpretation being an interaction of section 110 and section 111 have been considered in isolation to other terms of the contract in many of the cases until the 2007 House of Lords decision in *Melville Dundas Limited (In Receivership) and Ors v George Wimpey UK Limited and Ors.*<sup>46</sup> In this case the House of Lords reminded us that these implied terms may need to be considered within the context of the other terms of the contract.
108. This was the first time that the HGCRA reached the House of Lords. The dispute here, which related to the payment part of that legislation, highlighted the tension between an employer’s payment obligations and the impact on those obligations of the contractor going into administration. Here, on 2 May 2003, Melville applied for an interim payment. No withholding notice was served. The final date for payment was 16 May 2003. Wimpey did not pay, but on 22 May 2003 administrative receivers were appointed.
109. Clause 27.6.5.1 of the contract, the Scottish Building Contract, with Contractor’s Design, as is typical, stated that in these circumstances the parties must wait until the works are finished. Then an account will be taken and any balance paid to the receiver. The Scottish CA and the minority of the House of Lords were of the view that at the time the receivership was announced, the payment was due as no notice of

43. Paragraph 43.

44. [2008] CSOH 64, 17 April 2008, Lord McEwan.

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withholding had been served. If the final date for payment has passed, then the notice requirements of section 111 cannot be applicable as they have to be implemented before the final date for payment. Therefore the monies ought to be handed over to the receivers.

110. And this of course represents the tension described above. When a contractor's employment has been determined and a receiver appointed, two consequences follow. The contractor no longer has any duties to perform and the liability to make interim payment is no longer provisional. While the employer retains the money, he can set it off against his cross-claim for non-completion against the contractor. More often than not, the cross-claim will exceed any claim the contractor may have for unpaid work. Once the employer has paid the money, it will be gone, swept up by, for example, floating charges. If Wimpey paid the money over, it would never see it again.
111. In the House of Lords there was limited discussion about the payment provisions of the HGCR. Lord Hoffman noted that the object of these clauses was to introduce clarity and certainty as to the terms for payment and to dictate to the construction industry what those terms should be. He did not feel that section 110 necessarily achieved this, in particular with regard to the notice provisions. He agreed with other commentators that serving a notice under section 110(2) seemed to have no consequences. There was no penalty for doing so. He described its purpose as being "something of a puzzle" and noted that it seemed "to have dropped from heaven into the legislative process on its last day in the House of Commons".
112. However, the crux of the issue was section 111. Was Wimpey entitled to withhold the interim payment when it did not serve a notice before the final date for payment on 16 May 2003? It would not have been possible for Wimpey to serve such a notice by 11 May 2003. The earliest that they could have known they were entitled to withhold the interim payment was when the receivers were appointed on 22 May 2003.
113. Lord Hoffman said the purpose of the section 111 notice is to enable the contractor to know immediately and with clarity when a payment is being withheld. The notice is part of the machinery of adjudication in that it provides information which the contractor can challenge through adjudication if he so wishes. Clause 27.6.5.1 did not extend the final date for making an interim payment. He thought that the problem here had arisen because Parliament had not taken into account that parties would enter into contracts under which the ground for withholding a payment might arise after the final date for payment.
114. Lord Hoffman decided that here section 111(1) "*should be construed as not applying to a lawful ground for withholding payment of which it was not possible for notice to have been given within the statutory time frame.*" Therefore he allowed the appeal.
115. Lord Hope of Craighead also allowed the appeal but for slightly different reasons. He chose to give a "purposive" construction to section 111(1). Some might consider this to be an interesting choice of word given the reluctance of the Court of Appeal to adopt such an approach to construing section 107 in *RJT*. The mischief that section 111 addresses is to reduce the incidence of set-off abuse by formalising the process by which the payer claims to be entitled to pay less than that expected by the payee. Therefore, Lord Hope took the view that section 111 should not apply to situations where the employer wishes to exercise right of set-off given by Clause 27.6.5.1 when he has determined the contractor's

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45. Paragraph 13.

46. [2007] UKHL 18.

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employment under the contract. Thus the view of the majority was that Wimpey could hold on to the money.

116. The case of *Pierce Design International Limited v Mark Johnston and Another*<sup>47</sup> was the first case to consider the effect of Melville Dundas. Here, the principle dispute between the parties was whether an employer, who had not paid sums due, could prevent the contractor from enforcing its right to payment of those sums by relying on its subsequent determination of the contractor's contract.
117. The defendants, Mr. and Mrs. Johnston, owned a house in South West London and engaged the claimant, Pierce Design International, under a 1998 JCT Standard Form of Building Contract (with Contractor's Design) to carry out construction works to the property. During the course of the contract, the defendants failed to make several interim payments to the claimant. Withholding notices had not been served in accordance with the HGCRA, and the total unpaid sums amounted to approximately £93,500. Subsequently, the works were not completed by the completion date and the defendants complained that Pierce was not proceeding regularly and diligently with the work. After serving a notice of default pursuant to Clause 27.2.1 of the JCT Conditions, the defendants purported to determine the employment of the claimant. Pierce sought summary judgment for the unpaid sums plus interest.
118. The claimant contended that as Clause 27.6.5.1 of the contract allowed the employer not to pay a sum which was due, despite the absence of a withholding notice, it failed to comply with section 111 of the HGCRA and should therefore be struck down. The claimant also submitted that even if the clause was in accordance with section 111, the proviso to this clause operated to prevent the defendants from resisting the claimant's application for the sums due under the contract on the basis that those sums have been "unreasonably not paid".
119. HHJ Coulson first considered *Melville Dundas* and held that the court was bound by the House of Lords decision such that Clause 27.6.5.1 complied with the HGCRA, regardless of the facts of the case. He held that it would be "a recipe for uncertainty and endless dispute" if a clause in a standard JCT contract complied with the HGRCA based on one set of facts, yet on another set of facts it did not comply. HHJ Coulson, quoting Lord Hoffmann, stated that:
- "Employers should be "discouraged from retaining interim payments against the possibility that a contractor who is performing the contract might become insolvent at some future date (which may well be self-fulfilling)". It is not a determination of their rights. All it does is to require them to pay, on an interim basis, the sums, which, pursuant to the contract, they ought to have paid months ago."<sup>48</sup>
120. The judge then considered the proviso to Clause 27.6.5.1 and held that as there were clearly amounts due to be paid to the contractor prior to the date of determination, the employer had "unreasonably not paid" these amounts and accordingly, as a matter of construction, this non-payment amounted to a breach of the contract. The clause therefore operated and *Pierce* was owed the sums due. Summary judgment was granted to the claimant.

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47. [2007] EWHC 1691.

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## Suspension under section 112

121. Section 112 states:

“Right to suspend performance for non-payment

- (i) Where a sum due under a construction contract is not paid in full by the final date for payment and no effective notice to withhold payment has been given, the person to whom the sum is due has the right (without prejudice to any other right or remedy) to suspend performance of his obligations under the contract to the party by whom payment ought to have been made (“the party in default”).
- (ii) The right may not be exercised without first giving to the party in default at least seven days’ notice of intention to suspend performance, stating the ground or grounds on which it is intended to suspend performance.
- (iii) The right to suspend performance ceases when the party in default makes payment in full of the amount due.
- (iv) Any period during which performance is suspended in pursuance of the right conferred by this section shall be disregarded in computing for the purposes of any contractual time limit the time taken, by the party exercising the right or by a third party, to complete any work directly or indirectly affected by the exercise of the right.
- (v) Where the contractual time limit is set by reference to a date rather than a period, the date shall be adjusted accordingly.”

122. Section 112 is potentially a powerful provision, marking a substantial departure from the ramifications of the common law position. The general common law position is that where a paying party fails to pay one or more instalments the questions as to whether this amounts to a repudiation of contract would depend upon the circumstances and facts of each case. Failure simply to pay one instalment when many instalments might be due under a particular contract will not amount to a repudiation of contract.<sup>49</sup> The question of whether the failure to pay a number of instalments over a lengthy contract amounts to a repudiation is a grey area. However, if the contractor leaves the site during the course of the works then that will be taken to be a repudiation where the contractor leaves site not intending to return. If a contractor leaves site refusing to return until payment is made then under the pre-HGCRA common law position there would almost undoubtedly be an argument as to whether it was the employer or the contractor that repudiated the contract first.

123. Section 112 therefore provides the contractor with a statutory right to suspend works providing that the paying party has failed to pay in full by the final date for payment, or no effective notice to withhold has been given and the seven day notice of his intention to suspend has been issued.

124. There is surprising little case law on section 112. However, *HHJ Lloyd QC in Palmers Limited v ABB Power Construction Limited*<sup>50</sup> made it clear that the serving of a written notice precedes any right to suspend. This is of course unsurprising given the requirement in the HGCRA. However, the real argument related to the validity of the suspension notice. In *Palmers*, the judge preferred to leave the substantive issues to the adjudicator as he was simply dealing with the question as to whether the adjudicator had any jurisdiction. Nonetheless, section 112 still provides a fertile ground for dispute.

125. It is not uncommon for the validity of a section 112 notice to be

48. Paragraph 38.



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challenged. Arguments will relate to whether the paying party had not in fact paid in full, perhaps because of confusion and ambiguity in the payment and valuation process relating to that particular contract. Further, a continued failure to make payment may lead to a further right for the contractor to determine the contract after an extended period of suspension. Questions may then arise as to whether the contractor has in fact suspended. Does suspension mean that the contractor must have entirely left the site and carried out no work whatsoever? It is acceptable in those circumstances for the contractor to maintain presence on the site for the purposes of security, perhaps also for the purposes of safety. And might that extend to clearing the site of any danger, hazards or simply sweeping the site in order to avoid potential slips and trips?

### Prohibition of conditional payment provisions

126. Section 113 of the HGCRA makes payment provisions that are conditional on the payor receiving payment from a third person, unless that third person is insolvent, ineffective. Keating has referred to this as a partial exclusion of “pay-when-paid” clauses.<sup>51</sup>
127. A distinction was made in respect of pay-when-paid and pay-if-paid in the New Zealand case of *Smith & Smith Glass Limited v Winston Architectural Cladding Systems Limited*.<sup>52</sup> In that case the subcontractor, Winston was to provide curtain walling for a commercial property. They sub-subcontracted the glazing work to Smith. The main contractor went into receivership in December 1989. Winston then purported to terminate the employment of Smith. Smith then sought to recover \$100,000 for work done. Winston disputed liability, but said that in any event it would not be liable to pay Smith until it had itself been paid. They relied upon the payment clause which stated:
- “Payment will be made within five working days of receipt of the client’s cheque [and] we will endeavour (this is not to be considered a guarantee) to pay claims within five days, after payment to [us] of monies claimed on behalf of the sub-contractor.”
128. Smith argued that there was a distinction between a clause that operated as a condition precedent and one that simply identified a time for payment. In other words, a clause in which an obligation to make payment only arises if paid (pay-if-paid), compared to a clause that simply defines a time for payment (pay-when-paid).
129. The judge considered that this clause could do no more than identify the time when payment was to be made. If the parties intended that payment by a third party to one of the contracting parties had to be made before that party paid the other, then a clear condition precedent to payment would need to be “spelled out in clear and precise terms and accepted by both parties”. The clause was held to do no more than identify the time at which certain things must be done in order for payment to be made. It could not be considered an “if” category clause that prevented payment.
130. In the United States, a similar clause attempting to make payment of a subcontractor subservient to the main contractor was construed as merely postponing payment for a reasonable time.<sup>53</sup> The term could not disentitle a subcontractor from payment because of the employer’s insolvency.
131. Section 113 of the HGCRA prohibits conditional payment provisions. It states:

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49. See in particular *Mersey Steel & Iron Co Limited v Naylor Benson & Co* [1884] 9 App Cas 434, HL and *Decro-Wall International S.A.V. Practitioners in Marketing* [1971] 1 WLR 361, CA.  
50. [1999] BLR 426.

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“A provision making payment under a construction contract conditional on the payer receiving payment from a third person is ineffective, unless that third person or any other person payment by whom is under the contract (directly in or indirectly) a condition of payment by that third person, is insolvent.”

132. Insolvency is then defined. Perhaps, therefore, somewhat ironically, pay-when-paid clauses were prohibited by section 111, but a clause stating that payment will not be made in the event of the upstream payer’s insolvency will be effective.
133. One question that arose in respect of the operation of this provision, was whether it only applies where the relevant party is insolvent at the time that the construction contract was entered into, or whether the clause is effective if the relevant party becomes insolvent during the project.
134. While the question may not be entirely resolved, HHJ Lloyd QC in the case of *Durabella Limited v J Jarvis & Sons Limited*<sup>54</sup> considered the operation of this section, and stated that if a contractor was not guaranteeing the employer’s solvency, then it was right that the risk of the employer’s insolvency “may legitimately be shared”. The implication of this approach, arguably, is that the exception applies at the point in time at which the payment is to be made under the contract, and not upon entering into the contract.
135. In the case of *Midland Expressway Limited v Carillion Construction Limited and Others (No. 2)*,<sup>55</sup> Mr Justice Jackson QC considered the operation of section 113. The four defendant contractors worked together in a joint venture known as CAMBBA. The Secretary of State granted a Concession Agreement in February 1992 for MEL to design, construct and operate the Birmingham Northern Relief Road, known as the M6 Toll Road. Midland and CAMBBA entered into a design and construct contract in September 2000.
136. CAMBBA contended that a dispute had arisen in connection with payment arising from Change No. 11 to the design and construct contract. CAMBBA wished to refer the dispute to adjudication. Midland sought a declaration and injunction to prevent the building contractors from referring the claim to adjudication.
137. MEL contended that on the true interpretation of the contract, the adjudicator did not have any jurisdiction. The proper dispute was between the Secretary of State and MEL and CAMBBA, where MEL were simply a conduit between CAMBBA and The Secretary of State. Further, Clause 7.1.3(a) stated that the contractor would only be entitled to payment if it followed the conditions precedent set out in the design and construct contract. Clause 7.1.4 required a determination of the price adjustment to the Concession Agreement, and further that the money had been certified and paid to MEL under the Concession Agreement.
138. HHJ Jackson QC noted that the parties had conceded that the design and construct contract was a construction contract under the HGCRA. CAMBBA’s request for payment had been rejected. As a result there was a dispute between the parties which could be referred to adjudication. The condition precedent requiring a resolution under a separate contract for payment before making payment under the design and construct contract was exactly the sort of thing that section 113 of the HGCRA guarded against. The pay-when-paid provision was therefore ineffective. CAMBBA did not have to wait until any issue in respect of its payment had been resolved under the dispute resolution procedure in the Concession Agreement.

51. *Keating on Building Contracts*, 7th edition, paragraph 15-15J.

52. [1992] 2 NZ LR 4733; (1993) CILL 898.

53. *Thomas J. Dyer Co Limited v Bishop International Engineering Company* 303F. 2d 655 (USA) [1962].

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139. In conclusion, the declaration and injunction sought by MEL was not granted. CAMBBA was entitled to proceed with the adjudication.
140. Some have argued that while the HGCRA goes some way to alleviating delay in subcontractor payment, at the same time it gives credence to clauses which state that payment will not be made in the event that the person making payment does not receive his payment because of the insolvency of some third party payer.
141. Further, the HGCRA does not apply in all circumstances. Nonetheless, it may be arguable that the Unfair Contract Terms Act 1977 might make the clause subject to the requirements of reasonableness.

**Nicholas Gould**  
**11 September 2008**

54. 19 September 2001.

55. [2005] EWHC 2963, TCC.