Fenwick Elliott
The construction & energy law specialists

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Welcome to the December edition of ***Insight***, Fenwick Elliott's newsletter which provides practical information on topical issues affecting the building, engineering and energy sectors.

This issue focuses on an important issue that has recently come back in to the limelight: the payment regime under the Local Democracy, Economic Development and Construction Act 2009 ("LDEDCA").

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Payment in Practice under Part 8 of the Local Democracy, Economic Development and Construction Act 2009

This final issue of Insight of 2014 focuses on an important subject that has been out of the limelight for some time, but which has come back into focus in time for the Christmas break: the payment regime under the Local Democracy, Economic Development and Construction Act 2009 ("LDEDCA").

We last wrote about the "new" (as it then was) payment regime in issue 18 of Insight, two years ago this month[1]. The payment regime was preceded by eight years of debate and months of delay before finally being implemented on 1 October 2011, and a flurry of case law was expected to follow in its wake. To the surprise of many, there has been no reported case law on the payment regime until very recently, when the decisions in *ISG Construction Ltd v Seevic College* [2014] EWHC 4007 (TCC) ("*ISG v Seevic*") and *Harding (t/a MJ Harding Contractors) v Paice and another* [2014] EWHC 3824 (TCC) ("*Harding v Paice*") were handed down by the Judge in Charge of the Technology and Construction Court, Mr Justice Edwards-Stuart, within two weeks of each other earlier this month.

This 42nd issue of Insight (i) provides a reminder of the key principles of the payment regime; (ii) reviews the decisions in *ISG v Seevic* and *Harding v Paice*; and (iii) provides practice points in relation to both payment and adjudication going forward in light of Mr Justice Edwards-Stuart's judgments in *ISG v Seevic* and *Harding v Paice*.

Last (but by no means least) we are ending 2014 with a festive quiz which has been designed to test your knowledge of the topics covered in earlier issues of Insight this year. If you wish to participate, please tick the correct answers and return by email to Lisa Kingston lkingston@fenwickelliott.com. The winner will be announced in the January 2015 issue of Insight and (most importantly!) will be rewarded with a case of bubbly.

A reminder of the key principles of the payment regime

The starting point for the payment regime is the payment due date. The payment due date is either prescribed by the contract, or, in default of contractual provision, the Scheme for Construction Contracts (England and Wales) Regulations 1998 (as amended) ("the Scheme") will apply. Under the Scheme, the payment due date is whichever is the later of (a) the expiry of 30 days following the completion of the work, or (b) the making of a claim by the payee.

The payment process is as follows:

1. The Payment Notice is due from the Employer/Main Contractor or Employer's agent (such as the Architect, QS, Engineer or contract administrator ("Payer"), or, if the contract so provides, Contractor or Subcontractor ("Payee") within five days of the due date for payment (under the Scheme), or as otherwise provided by the contract. The Payment Notice must state the sum which is considered due and the basis on which that sum is calculated. A Payment Notice must be issued even if the sum due is zero, which will most commonly be the case during the defects liability period.

2. If no Payment Notice is served, any preceding payment application issued by the Payee will stand as the Payment Notice, provided the payment application meets the requirements of a valid Payment Notice in that it states the sum which is considered due and the basis on which that sum is calculated.

3. If no Payment Notice is issued, or the Payment Notice served is invalid, the Payee must immediately issue a Default Payment Notice stating the sum which is considered due and the basis upon which that sum is calculated. The service of a Default Payment Notice will extend the final date for payment by the number of days between the date on which the Payment Notice

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should have been served and the date of service of the Default Payment Notice.

4. If the Payer wishes to dispute the sum that is stated to be due in the Payment Application, Payment Notice or Default Payment Notice, the Payer may serve a Payless Notice stating the sum which is considered to be due and the basis on which that sum is calculated. The Payless Notice is due seven days before the final date for payment under the Scheme, or as otherwise provided by the contract. The effect of the Payless Notice is to revalue the contractor's work as at the date of service of the Payless Notice, and the revaluation can take account of any LADs, set-offs or abatements.

ISG v Seevic

The facts

The Employer, Seevic College ("Seevic") retained ISG Construction Limited ("ISG") to carry out work under the terms of a JCT Design and Build Contract 2011 ("the Contract").

Under the terms of the Contract, ISG was required to submit monthly interim payment applications stating the sum it considered to be due and the basis upon which that sum was calculated. The final date for payment was fourteen days from the due date. The Contract further contained the usual procedure whereby Seevic was to serve a Payment Notice not later than five days after the due date stating the amount it considered to be due. If Seevic intended to pay less than the amount stated in the Payment Notice or interim application, it was to serve a Pay Less Notice no later than five days before the final date for payment.

ISG duly submitted its payment application and Seevic failed to either make payment or issue a Payless Notice, as a result of which ISG referred the dispute to adjudication ("the first adjudication"). In its Notice of Adjudication, ISG asked the adjudicator to determine the contractual value of its work as at the date of the payment application. The adjudicator found that ISG was entitled to the full amount it said was due in its interim payment application (which also stood as the Payment Notice) because Seevic had failed to comply with the notice procedure set out in the Contract and serve a Payless Notice.

Four days before the decision was issued in the first adjudication, in an attempt to circumvent its failure to serve a Payless Notice, and concerned that it might lose the first adjudication, Seevic issued a Notice of Adjudication ("the second adjudication"). Seevic's Notice of Adjudication asked the adjudicator to determine the value of ISG's works as at the date of ISG's payment application.

Seevic argued that, notwithstanding the first adjudication, there was a separate dispute in relation to the value of ISG's works that could be referred to adjudication. This separate dispute provided the adjudicator with jurisdiction to decide the value of ISG's works and, accordingly, the amount that was due to ISG. The second adjudicator (who incidentally also decided the first adjudication) found that the value of the works was lower than that stated in ISG's payment application, and ordered ISG to repay the difference between the sum it had received in the first adjudication and the true value of the interim payment application as determined by the second adjudication.

Following the two adjudications, ISG made an application for (i) summary judgment to enforce the first adjudicator's decision (on the basis that its interim payment application was agreed in the absence of a valid Payless Notice to the contrary under the Contract) and (ii) a declaration that the second adjudicator's decision was unenforceable (on the basis that the second adjudicator lacked jurisdiction).

The decision

Mr Justice Edwards-Stuart noted that *ISG v Seevic* was very similar to *Watkin Jones & Sons Ltd v Lidl UK Gmbh* [2001] EWHC 453 (TCC) which was concerned with the payment regime under the JCT Standard Building Contract with Contractor's Design, 1998 edition. In that case, the employer had also failed to comply with the notice provisions under the contract, and had used adjudication proceedings as a means of revaluing the contractor's payment application.

Mr Justice Edwards-Stuart followed the decision in *Watkin Jones & Sons Ltd v Lidl UK Gmbh* and held that, in the absence of fraud, contractors are entitled to the amount stated in their payment application regardless of the true value of that work in circumstances where the employer does not serve a valid Payless Notice. The first adjudicator had decided that the sum claimed in the payment application was the sum that was due to ISG, that sum had been agreed by Seevic in the absence of a valid Payless Notice, and the contractual notice regime prevented any argument to the contrary. Any decision otherwise would have the effect of completely undermining the statutory regime.

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The judge pointed out that the contractor's only entitlement to payment is through the interim application machinery, or at the final account stage at the end of the project: the contractor has no entitlement to be paid the value of his work during the course of the works. Equally, Seevic had no contractual entitlement to a revaluation, let alone a financial award in consequence of it.

As regards the second adjudication, Mr Justice Edwards-Stuart found that the second adjudicator lacked jurisdiction as he had decided the same or substantially the same dispute as that which was decided in the first adjudication, and his second decision was therefore unenforceable.

Harding v Paice

The facts

Mr Paice and Ms Springall (together "Paice") were property developers who engaged MJ Harding ("Harding") to carry out residential works to two properties in Surrey under the terms of a JCT Intermediate Building Contract 2011 (with amendments) ("the Contract") in March 2013.

Work commenced in April 2013, but the relationship between the parties deteriorated and Harding gave notice to terminate the Contract in January 2014. The termination provisions provided that (i) Harding was required to submit a final account in respect of the work it had carried out, including the total value of the work properly executed, up to the date of termination (under Clause 8.12.3); (ii) Paice was to pay the amount that was "properly due" in respect of the account within 28 days of submission of its final account (under Clause 8.12.5); and (iii) Paice had the option to commence adjudication or litigation within 28 days of the issue of the Final Certificate, in which case the Final Certificate ceased to be conclusive (Clause 1.9).

Paice did not make payment, and the scenario was almost identical to that in *ISG v Seevic* in that Harding commenced adjudication proceedings claiming it was due the sum in its final account on the basis that Paice had failed to serve a valid Payless Notice, and Paice issued counter-adjudication proceedings in an attempt to revalue Harding's final account.

Rather than let Paice's counter-adjudication go ahead, Harding applied for an injunction to prevent it from proceeding. Harding argued that the failure by Paice to serve a valid Payless Notice meant that the sum in its final account became the amount that was "properly due" under Clause 8.12.3 of the Contract. Harding further argued (in identical terms to ISG) in the alternative, that the substance of its account had been already referred to adjudication and it could therefore not be revisited.

The decision

Mr Justice Edwards-Stuart noted that Clause 8.12.5 was curious because, unlike the interim payment machinery in the Contract, it did not require the employer to pay the amount stated in the contractor's interim account. Instead, the employer was to pay the amount "properly due" in respect of the account, in order to reflect the reckoning process that is inherent in final accounts.

The judge further noted that the adjudicator appeared to have proceeded on the basis that if Paice wished to pay less than the sum in Harding's account, it had to serve a valid Payless Notice. In the absence of a valid Payless Notice, the adjudicator concluded that Paice had to pay the amount stated in Harding's account (incidentally, Mr Justice Edwards-Stuart came to the same conclusion in relation to Seevic's failure to serve a Payless Notice in ISG v Seevic, albeit the crucial point to note is that ISG v Seevic concerned an interim account, not a final account).

Mr Justice Edwards-Stuart disagreed with the adjudicator's conclusion in relation to Paice's failure to serve a valid Payless Notice. He pointed out that if the adjudicator's conclusion was correct, it would deprive the employer forever of the right to challenge the contractor's account, and in some cases (for example, if the contractor had considerably overvalued its account), the contractor would be permitted to receive a windfall to which he would otherwise not be entitled, and which the employer could never recover.

In terms of the jurisdiction argument (i.e. that the substance of Harding's account had already been referred to adjudication and could therefore not be revisited), Mr Justice Edwards-Stuart held that, as a matter of fact, the adjudicator had not determined the amount "properly due" to Harding under Clause 8.12.3. Instead, the adjudicator had reached the conclusion that the absence of a valid Payless Notice automatically meant that the sum claimed in the final account was due and had to be paid.

Some practice points

- As yet, there is no reported case law as to the level of detail that might be necessary for the breakdown of the sum due and the basis on which the sum is calculated. You should therefore err on the side of caution and include a detailed breakdown with reference to the contractual matrix, rather than provide insufficient detail and risk your Notice being rendered invalid.

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- If the employer fails to serve a Payment Notice and the contractor serves (i) a valid payment application that qualifies as a Payment Notice or (ii) a Default Payment Notice, and the employer does not serve a valid Payless Notice, then the contractor's payment application/Payment Notice or Default Payment Notice will stand. The amount due to the contractor will be the sum which is set out in the payment application/ Payment Notice or Default Payment Notice. The Notices are in practical terms a "battle of the forms" in that the last served valid Notice will trump all previous Notices, and be determinative of the sum due.
- If the employer fails to serve a Payless Notice, it is taken to be agreeing the value stated in the payment application/Payment Notice, other than where the final account falls to be considered.
- If the employer fails to serve a valid Payless Notice, it is no longer entitled to seek a repayment of money paid to the contractor in subsequent adjudication proceedings by seeking a revaluation of the contractor's interim account.
- As a matter of contractual entitlement, employers can only revalue the contractor's work on (i) the valuation dates for interim applications as determined by the contract upon service of a valid Payless Notice, or (ii) at the final account stage. This is so, irrespective of the true value of any work that might be carried out by the contractor at any given stage during the course of the project.
- It is likely, following the decision in *Paice v Harding*, that Payless Notices will not apply to final accounts as this would have the effect of preventing the employer from challenging the contractor's final account.

Conclusion

The decision in *ISG v Seevic* on interim accounts is entirely in keeping with the "pay, now, argue later" ethos of the LDEDCA, and it ought to improve cash flow for contractors. It should also put an end to the current practice regarding interim accounts, whereby some employers who fail to serve a Payless Notice commence separate adjudication proceedings in order to argue that there is a separate adjudicable dispute in relation to the value of the contractor's works. Such tactics are a throwback to the previous regime that was concerned with the "amount due",[2] as opposed to the amount that is said to be due on the face of the Payment Notice or Default Payment.

As for final accounts, following *Harding v Paice*, it is unlikely going forward that a failure by the employer to serve a Payless Notice will be critical to its ability to challenge the contractor's final account, as this would create a very unfair situation whereby the employer would be prevented from challenging the contractor's final account for all time.

Footnotes

1. See http://www.fenwickelliott.com/files/insight_issue_18.pdf.
2. The old system was mired with problems, including how abatements should be dealt with, and it often presented difficulties where the contract provided for payment against certificates but no certificates were ever issued.

Please continue for the quiz.

Should you wish to receive further information in relation to this briefing note or the source material referred to, then please contact Lisa Kingston.
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2014 Christmas Quiz

(Please tick the correct answers and return to Lisa Kingston, lkingston@fenwickelliott.com)

Question 1

Which of the following should you not do when faced with an invitation to mediate:

- ☐ Respond promptly, confirm dates on which you are available, and suggest some possible mediators.
- ☐ Request any further documents or information you consider you may require for the purposes of the mediation.
- ☐ Deal with any potential obstacles to mediation with a 'can do' attitude (for example, your opponent may be based on the other side of the country, in which case you might mediate at a neutral venue that is equidistant to you both).
- ☐ Ignore it, in the hope your opponent will give up on the idea of mediation.

Question 2

What test do the courts apply to relief from sanctions (whereby parties seek indulgence from the court in the event they fail to comply with a court rule, court order, or court practice direction)?

- ☐ (Stage 1) Assess the significance and seriousness of the default which led to the application for relief;
  (Stage 2) if the breach is significant and serious, consider why the default occurred and whether there was a good reason for it;
  (Stage 3) (irrespective of any conclusion that might have been reached at Stages 1 and 2) evaluate all the circumstances to enable the application to be dealt with justly: namely, the need (i) for litigation to be conducted efficiently and at proportionate cost and (ii) to enforce compliance with court rules, practice directions and court orders.
- ☐ The relevant sanction for any breach of a court rule will be applied unless the breach was trivial, or there was "good reason" for it (such as if a party or its solicitor had suddenly been taken seriously ill).

Question 3

To what type of court application does the above test not apply?

- ☐ Those that are made after the deadline for compliance has passed.
- ☐ Those that are made before the deadline for compliance has passed.

Question 4

What is the best approach to take when contracting under NEC3?

- ☐ Sign it, leave it in the draw, proceed as if it's a JCT contract, and only get it out if there is a problem.
- ☐ Assume that no amendments have been made and proceed on the basis of the last job you did under NEC3.
- ☐ Take care to remind yourself of the respective obligations of the Employer and Contractor, (particularly as regards the Scope and Services) so that you are in the strongest possible position to proactively address any problems that might arise.

Question 5

You are contracting under NEC3 and your contract requires you to provide a performance bond in favour of the Contract Administrator. When you are asked to provide the bond, you are unable to do so as your contract has already been terminated and your usual bond markets are unwilling to issue a performance bond for a terminated contract. What is the court most likely to ask you to do in this situation?

- ☐ Let you off; you tried, at least.
- ☐ Give you a final chance to establish that your obligation to provide the performance bond and warranties was impossible and order you use your best endeavours to procure it, failing which you must provide specific performance of the bond by paying a sum of money into court of equivalent value to the bond.

Question 6

Which of the following statements is incorrect:

- ☐ True to their name, on-demand bonds are payable on demand regardless of the surrounding circumstances.
- ☐ If there is a clear case of fraud by the beneficiary, then a call on the bond will be restrained by the court.
- ☐ On-demand bonds are as a general rule payable on demand without reference to the underlying contract or any liability arising under that contract, unless there is strong evidence that the terms of the underlying contract clearly and expressly prevent the beneficiary from making a call, in which case the court may be prepared to restrain a call.

Question 7

Which of the following is misleading:

- ☐ It is very difficult to contest an adjudicator's decision on the merits.
- ☐ Even if you can identify an error in an adjudicator's decision, it will probably not invalidate it.
- ☐ Provided the adjudicator understands the question asked of him and answers it in a manner which is fair to both parties, he will not breach the rules of natural justice, even if he answers the right question incorrectly.
- ☐ Adjudicators commonly refer to their own professional experience without providing advance notice to the parties of their intention to do so. A breach of the rules of natural justice will usually occur as a result.

Question 8

When does time start to run for limitation purposes to contest an adjudicator's decision under a Scheme adjudication?

- ☐ Six years from the date on which the decision was issued.
- ☐ Six years from the date on which the paying party made payment.
- ☐ Six years from the date of issue of the Notice of Adjudication.