When does the pay less notice regime apply?

Laura Lintott of **Dentons UK and Middle East LLP** analyses the pay less notice regime in the wake of last year's Court of Appeal ruling on whether the *Construction Act* applies to final payment applications made after contract completion or termination.

KEY POINTS

- **A review of the decision in *Adam Architecture Ltd***
- **The Court of Appeal has held that s 111 of the *HGCRA 1996* applies to both interim applications and any final account or termination account**
- **An employer cannot resist a payment application without serving a pay less notice – even if the construction contract has been terminated**
- **The employer must pay the sum stated to be due and argue about it afterwards**

Late in 2017, the Court of Appeal (CA) was asked to decide whether s 111 of the *Housing Grants, Construction and Regeneration Act 1996* (as amended in 2011) (*Construction Act*), applies to final payment applications made after completion or termination of the contract. Does an employer have to serve a pay less notice if it disagrees with the amount applied for by the contractor? In responding yes to this question, the CA's decision in ***Adam Architecture Ltd v Halsbury Homes Ltd [2017] EWCA Civ 1735*** provides useful clarification on how to interpret s 111 of the *Construction Act*.

Before relaying the facts of the case, Lord Justice Jackson was careful to set out in full the payment terms covered by ss 109 to 111 of the *Construction Act* – both the old, 1996 version and the latest, 2011 version. (All sections here refer to the 2011 version of the *Construction Act*.)

Here is a reminder of the key requirements of s 111 for an employer to serve a pay less notice if it intends to pay less than the notified sum.

Section 111(1) provides:

> 'Subject as follows, where a payment is provided for by a construction contract, the payer must pay the notified sum (to the extent not already paid) on or before the final date for payment.'

Section 111(3) states:

> 'The payer of a specified person may in accordance with this section give to the payee a notice of the payer's intention to pay less than the notified sum.'

What was the dispute in the *Adam Architecture Ltd* case?

Adam Architecture Ltd (Adam), a company of architects, was appointed under a professional services appointment by Halsbury Homes Ltd (Halsbury), a property developer, in connection with a residential development to construct 200 homes in Loddon, Norfolk.

Halsbury accepted Adam's fee proposal to carry out its work in four stages and Adams started work under the Conditions of Appointment for an Architect published by the Royal Institute of British Architects (RIBA) 2012 edition (RIBA Conditions). Their arrangement, however, quickly fell apart.

On 2 December 2015, Halsbury terminated Adam's appointment without notice.

The RIBA Conditions contained a term allowing either party to terminate on notice.

On 3 December 2015, Adam submitted an invoice for £46,239 for work undertaken on parts of all four stages (December Invoice).

Halsbury failed to serve a pay less notice and also failed to pay Adam for work done up until 2 December 2015 under the December Invoice.

In February 2016, Adam commenced an adjudication to recover payment of the £46,239 and a further £747 relating to an earlier invoice dated 21 October 2015.

What did the parties argue in the adjudication?

In the adjudication, Halsbury:

- Alleged that there was no contract as it came to an end before the invoices were sent.
- In the alternative, noted that it did not have to serve a pay less notice as the invoice was a final account. Halsbury based this argument on the premise that the payment notices required by the RIBA conditions and the *Construction Act* did not apply to final applications but only to interim applications for payment.

The adjudicator's ruling

The adjudicator disagreed with Halsbury and found in favour of Adam, mainly as Halsbury had failed to serve a pay less notice in relation to both of the invoices.

The adjudicator awarded Adam the amount of both of their outstanding invoices, plus interest and costs pursuant to the RIBA Conditions.

What were the arguments in the TCC?

Halsbury did not comply with the adjudication award and both parties issued proceedings in the Technology and Construction Court (TCC).

Halsbury issued a claim under CPR Pt 8 for the following declarations:

- the *Construction Act*'s pay less regime did not apply to the December Invoice;
- Halsbury was not liable to pay that invoice; and
- the adjudicator's decision was unenforceable.

Adam issued a parallel application for summary judgment proceedings under CPR Pt 7 to enforce the adjudicator's decision. The two applications were heard together by Mr Justice Edwards-Stuart.

Adam argued that, as Halsbury had not issued a pay less notice, it was entitled to the full payment of both of its invoices.

Halsbury maintained that by 3 December 2015, the contract had been terminated. Even if it was still in existence, it did not have to serve a pay less notice in relation to the December Invoice as it was a final account.

The High Court's ruling

The first instance judge found in favour of Halsbury and granted all three declarations dismissing Adam's claims. The judge considered the contract to have been repudiated on 2 December 2015 and held that Halsbury was not contractually required to serve a pay less notice because:

- the contract was discharged and therefore neither party was required to perform its primary obligations (including Halsbury's obligation to serve a pay less notice under the contract);
- the December Invoice was a final account (within the meaning of cl 5.14 of the RIBA Conditions) and the invoiced sum was not the 'notified sum' under the contract (as defined in cl 5.14 of the RIBA Conditions); and
- the December Invoice was a termination account under cl 5.17 of the RIBA Conditions meaning that the invoiced sum was not the 'notified sum' (first sentence of cl 5.14 of the RIBA Conditions).

Did the Court of Appeal agree with the TCC?

Adam appealed to the CA on three grounds:

- Section 111 required pay less notices in respect of both interim applications and any final account or termination account.
- The judge should not have dealt with such a complex issue as repudiation in Pt 8 proceedings.
- The judge failed to decide the dispute subject to the adjudication.

At the CA hearing, Halsbury argued that Adam had not relied on the s 111 point in the adjudication, and should not be allowed to do so in court.

However, Jackson LJ stated (para [40] of the judgment):

> '... If this court is dealing with a dispute about payments due in relation to a construction project, it is unrealistic for us to ignore the relevant provisions of the 1996 Act. We must decide the dispute between the parties in accordance with the law. We would do a disservice to the construction

industry if we give a judgment which disregards the relevant statutory provisions.'

Jackson LJ accepted that the principal objective of the *Construction Act* is to maintain the cashflow of contractors and sub-contractors throughout the duration of the project but pointed out that there is no textbook authority stating that s 111 applies only to interim payments. Although s 109 is expressly limited to interim payments, the other sections refer only to 'payments'. Section 109(4) specifically clarifies this position by stating that ss 110 to 111 are wider in their scope than s 109.

Jackson LJ found that s 111 clearly relates to all payments which are 'provided by a construction contract' and is not limited to interim payments. (See para [48] of the judgment.) He refused to imply anything else into the statute.

Jackson LJ went on to review the case law including:

- ***Rupert Morgan Building Services (LLC) Ltd v Jervis [2003] EWCA Civ 1563*** in which a contractor successfully recovered payment on an interim certificate where the employer had failed to serve a withholding notice (as it was under the 1996 version of the *Construction Act*) under s 111. The CA discussed the impact of s 111 on both interim and final certificates noting that it was fundamentally about cashflow: it does not seek 'to make any certificate, interim or final, conclusive. In other words … the employer must pay the sum stated to be due and argue about it afterwards'. Jackson LJ pointed out that irrespective of the fact that ***Rupert Morgan*** relates to the old version of the *Construction Act*, the reasoning makes good sense holding that a contractor is entitled to refer issues concerning interim payments or the final account to adjudication.
- ***Melville Dundas Ltd (in receivership) v George Wimpey UK Ltd [2007] UKHL 18*** (also on the 1996 version of the *Construction Act)* in which both parties accepted that s 111 applied to both interim and final certificates.
- ***Harding (t/a MJ Harding Contractors) v Paice [2015] EWCA Civ 1231*** (which dealt with the 2011 version of the *Construction Act*) in which the adjudicator had ordered the employer to pay the full amount due on the contractor's final account under s 111 as the employer had failed to serve a valid pay less notice. Both parties accepted that s 111 applied to final certificates as well as interim certificates. The CA held that the employer had to pay the full amount and argue about the figures later.

Jackson LJ concluded that s 111 applies to both interim and final applications for payment. Therefore, Halsbury should have served a pay less notice if it wished to resist paying Adam's final account or termination account. The judge further held that the December Invoice was an account following termination pursuant to cl 5.17 of the RIBA Conditions. It was, therefore, a claim for money due under the contract and not a claim for damages for breach of contract. Accordingly, Adam had the benefit of the *Construction Act*'s payment regime and could recover payment on both outstanding invoices. It had not accepted any repudiatory breach but treated Halsbury's email dated 2 December 2015 as a termination of the engagement.

The CA therefore allowed Adam's appeal, dismissed Halsbury's Pt 8 proceedings and gave summary judgment in favour of Adam in the Pt 7 proceedings.

Conclusion

Adam Architecture Ltd disposes of any distinction in the requirement to serve a payment notice between interim and final applications. Section 111 of the *Construction Act* and the requirement to serve a pay less notice applies to interim and final payments as well as payments due following completion or termination of a contract.

One further point on the repudiation: Adam did not accept any repudiatory breach but instead treated Halsbury's email dated 2 December 2015 as a termination of the engagement without the appropriate notice. It immediately stopped work and notified Halsbury that it was doing so. Had the CA upheld the repudiation point, the appeal may have been unsuccessful as it is arguable that both parties have been discharged from their primary obligations under the RIBA Conditions, including any obligations imposed by the *Construction Act*.

The practical significance is clear: if employers believe final payments and those applied for after completion or termination of the works are not due, they must serve a pay less notice. Failure to do so will mean the sum becomes payable in full and, if it is not paid, the contractor will likely obtain an adjudication decision in its favour ordering payment. **CL**