Get it right or try again later: the new regime for interim payments

S&T (UK) Limited v Grove Developments Limited *[2018] EWCA Civ 2448*

We reported on the important decision of Coulson J (as he was then) at first instance in *Grove Developments Ltd v S&T (UK) Ltd* [2018] EWHC 123 (TCC) in the February edition of this Newsletter. The hotly anticipated decision of the Court of Appeal in the appeal against that decision has today been handed down. In a judgment given by Sir Rupert Jackson, the Court of Appeal has upheld the first instance decision of Coulson J.

At first instance Coulson J had overturned the line of authorities flowing from *ISG v Seevic*, holding that an employer is entitled to run a second adjudication to determine the 'true' value of an interim application for payment, even if the employer's payment notice and payless notice were invalid. The Court of Appeal has dismissed the appeal against that decision, and upheld Coulson J's decision. The reasoning given by Sir Rupert Jackson, in one of his final decisions before retirement from the bench, is highly significant for the construction industry.

Anthony Speaight QC and **Matthew Thorne** represented the contractor.

Background

By a JCT Design & Build Contract 2011, Grove engaged S&T to design and build a new Premier Inn Hotel at Heathrow Terminal 4. The parties fell into dispute about the sum payable as an interim payment and about the deduction of liquidated damages. Three issues arose for consideration by the Court of Appeal:

(1) What does the statutory and contractual obligation to "specify" the basis of calculation in a Pay Less Notice require? In particular, is it satisfied by incorporating a separate and unappended document by reference?

(2) Can an employer commence an adjudication seeking a decision as to the 'true' value of an interim application if its Payment or Pay Less Notice was invalid?

(3) What are the timing requirements for the notification provisions before an employer is entitled to levy liquidated damages under the JCT form?

Issue 1: How should the basis of calculation be "*specified*"?

The first issue before the Court was whether Grove's Pay Less Notice complied with the requirement of the contract that payment notices "*specify the basis of calculation*" of the sum stated to be due.

Grove's Payment Notice was out of time and invalid. Consequently Grove relied on its Pay Less Notice. This specified the sum stated to be due, but did not expressly set out the basis of calculation. Instead, it purported to incorporate by reference the calculation detailed in its earlier (invalid) Payment Notice.

S&T argued that this did not comply with the 1996 Act and the contract: the notice must expressly set out the basis of calculation on the face of that notice.

The Court of Appeal upheld the first instance decision that the Pay Less Notice was valid, stating that there is "*no bright line rule*". Sir Rupert Jackson held that:

> "*It is neither tenable to say that reference to other documents is always permissible nor to say that such reference is never permissible. As King LJ pointed out during Mr Speaight's submissions, it is a question of fact and degree in each case whether the purported Pay Less Notice achieved the requisite degree of specificity.*"

On the facts of the case, the calculations were understood, and there was no rule precluding incorporation by reference such as contained in the Pay Less Notice.

This decision may reflect a softening of the sometimes high hurdle for formal compliance with notice provisions reflected in recent decisions. Nevertheless, the test of "*fact and degree*" adopted by the Court could lead to uncertainty for parties as to whether the contractually required information was properly incorporated by reference. This may increase the number of factual disputes about whether the relevant Notice was valid. Despite this decision, parties would be well-advised to set out clearly the basis of calculation in their Notices to avoid any ambiguity.

Issue 2: The 'true' value of the sum due

The consequences of the Judgment on Issue 2 will be significant for the construction industry. Prior to the first instance decision in this case, it was well-established that, in respect of the JCT D&B 2011 (and similar forms), the sum to be paid by the employer was the sum "*stated as due*" in the relevant Notice; and, if the employer failed to issue a valid Payment Notice or Payless Notice, it would be bound to pay

the sum stated in the contractor's interim application for payment (see, for example, *ISG v Seevic* [2014] EWHC 4007, *Galliford Try v Estura* [2015] EWHC 412, *Kilker v Purton* [2016] EWHC 2616 and *Kersfield v Bray* [2017] EWHC 15).

The Court of Appeal has upheld the first instance overturning of that position, holding that an employer is entitled to commence an adjudication to determine the 'true' value of the interim account, even if it failed to issue a valid Payment Notice or Payless Notice – but only once the 'notified sum' has been paid.

Following a lengthy review of the authorities, the Court of Appeal made the following important findings:

(1) At common law, a building contract is an entire contract. The contractor has no entitlement to interim payments, save as provided by the contractual terms or by statute.

(2) The employer's immediate obligation is to pay the 'notified sum'. If it fails to do so, this can be enforced by adjudication, litigation, or arbitration.

(3) However, the sums payable are not conclusive as to the correct valuation of work done. That therefore remains a justiciable issue between the parties, if it is disputed. The wide powers of the Court (and, in consequence, of the adjudicator) permit opening up and revising the sums shown as due (as held in *Beaufort v Gilbert Ash* [1999] 1 AC 266).

(4) The payment mechanism is simply intended to generate a provisional figure for immediate payment. The adjudication provisions then facilitate a more detailed valuation of the work at that date, if required.

(5) The mechanism by which any overpayment is recovered is not, contrary to Coulson J's first instance judgment, by way of implied term or restitution. It is simply a dispositive remedy flowing from the adjudicator's re-evaluation.

Despite this, the Court concluded that, in order to avoid undermining the legislation, the 'value' adjudication could not be commenced until payment of the notified sum had been made. This was because the Act creates a *"hierarchy of obligations"* by which *"the adjudication provisions are subordinate to the payment provisions in section 111…The Act cannot sensibly be construed as permitting the adjudication regime to trump the prompt payment regime. Therefore, both the Act and the contract must be construed as prohibiting the employer from embarking upon an adjudication to obtain a re-valuation of the work before he has complied with his immediate payment obligation."* This clear requirement that the notified sum be paid first is a significant gloss on Coulson J's decision.

The practical consequences of this decision will now have to be worked out through adjudications and in the Courts, and some questions remain. In particular:

- It remains to be seen whether the ability to commence a 'true value' adjudication is limited to the JCT form, or whether the principle will operate more broadly. Since the Act provides only for the payment of a notified sum, it is assumed that everything will continue to depend on the contractual wording used in any given case.

- On what basis can 'true value' adjudications be prevented until payment of the notified sum has been made? Is an adjudicator without jurisdiction until payment has been made (which on one reading is implied in the Court of Appeal's judgment)? Can injunctions be obtained to prevent the continuation of such adjudications until the notified sum is paid? It is unclear how this rule will be applied in practice.

- Will this decision reduce the so-called 'smash and grab' adjudications, as was widely suggested following Coulson J's first instance decision? Or – due to the Court of Appeal's requirement for payment first - will it simply result in more adjudications (initially on the basis of notices, followed by second adjudications on value)?

Issue 3: Timing of notices for Liquidated Damages

The final issue examined by the Court of Appeal is unconnected to the payment regime, but raises an important point about notices relating to liquidated damages.

By clause 2.29 of the JCT form, an employer is required to take three steps before it can deduct liquidated damages:

(1) First, the issue of a non-completion notice (notice 1).

(2) Secondly, the employer must have notified the contractor that it "*may require payment of, or may withhold or deduct, liquidated damages*" (notice 2 - the Warning Notice).

(3) Finally, the employer must give notice that it "*requires*" the contractor to pay liquidated damages or "*will*" withhold or deduct liquidated damages (notice 3 – the Deduction Notice).

Grove sent the Warning Notice and Deduction Notice in the correct sequence, but in such quick succession that the former had not reached S&T's inbox before the latter was sent.

S&T contended that the Deduction Notice was invalid, because: (a) it had not received the Warning Notice before the Deduction Notice was sent, or (b) it had not been given time to read or digest the Warning Notice first. Thus, to use the contractual language, it had not been 'notified' by the Warning Notice before Grove 'gave notice' in the Deduction Notice.

The Court of Appeal rejected that argument, holding that

(1) The words "*notified*" and "*give notice*" both require the sending and receipt of a notice, so if both notices are received in the correct sequence that is sufficient to satisfy the requirements of the clause.

(2) No specific time period is required for a party to consider the Warning Notice before the Deduction Notice is received. Whilst the Court acknowledged that this robs the clause of any real purpose, it held that it is impossible to identify any specific period of time which should elapse between serving the two notices, and a requirement for a 'reasonable' lapse of time is unworkable and does not satisfy the requirements for an implied term.

This is a notable determination because it makes the Warning Notice a mere procedural hurdle. As the Court of Appeal acknowledged, the procedure provides *"no obvious benefit to anyone, if the employer warns the contractor of what he may do just seven or eight seconds before he actually does it"*. Nevertheless, *"However surprising it may seem to a judge, clause 2.29 of the contract requires no more than the giving of notices in a specified sequence. Judges should not generally impose their notions of commercial common sense upon the parties to business disputes. Provided that a scintilla of time elapses after giving notice 2 and before giving notice 3, that is sufficient."*

To the extent that parties wish to give some teeth to the Warning Notice, they may wish to consider a bespoke amendment to the standard form.

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