



CONSTRUCTION AND ENGINEERING ALERT

March 2015

PAYMENT CLAUSES IN CONSTRUCTION CONTRACTS - THE IMPORTANCE OF SERVING NOTICES

An employer's failure to serve the correct payment notices (a payment notice or pay less notice) under a construction contract can result in the contractor being entitled to all sums being claimed by him in his application for payment, notwithstanding his entitlement to such sums and the employer wanting to pay less.

THE CONSTRUCTION ACT

The Housing Grants, Construction and Regeneration Act 1996, as amended by the Local Democracy Economic Development Construction Act 2009, is the single most important piece of legislation affecting the UK construction industry.

The Act, commonly known as the "Construction Act", applies to all contracts for the carrying out of "Construction Operations" - which include the construction, alteration, maintenance, repair and demolition or dismantling of buildings.

Importantly, the Construction Act creates strict requirements relating to payment under construction contracts. The payment provisions, particularly in relation to the service of notices, were tightened up in 2011.

The first case since the introduction of these "new" payment provisions (three and a half years ago) is the recent case of *ISG Construction Ltd v Seevic College*.

The Court's decision serves as a stark reminder of the need to serve payment and pay less notices under construction contracts.

WHAT HAPPENED?

The Employer, Seevic College, engaged the Contractor, ISG, under a standard JCT design and build contract 2011 edition (in relation to which the "new" Construction Act payment provisions apply).

The building contract provided for the Contractor to make monthly applications for payment, which it did.

Pursuant to the building contract and the Construction Act, in response to an interim application for payment, the Employer is required to issue a payment notice and/or a pay less notice within a specified timeframe setting out the sum which the Employer considers due to the Contractor and the basis upon which this is calculated.

The Contractor submitted an interim application for payment of just over £1 million. The Employer failed to issue a payment notice or a pay less notice and, subsequently, did not pay the Contractor who in response commenced adjudication proceedings.

It was decided in the adjudication proceedings that the Employer was required to pay the sums stated in the Contractor's application for payment.

A SECOND ADJUDICATION

In anticipation of losing the first adjudication, the Employer commenced a separate adjudication. This related specifically to the value of works properly carried out and completed up to the date of ISG's payment application.

The second adjudication was decided in favour of the Employer namely that it was entitled to deduct in excess of £750,000 from the payment, which represented the over-valuation of building works which had been properly carried out and completed.

THE COURT'S DECISION

The Contractor applied to court to enforce the first adjudication award and set aside the second adjudication award.

The Court decided in favour of the Contractor on both counts.

The lack of a payment notice and pay less notice meant that the Employer could not challenge the value of the works claimed in the Contractor's payment application.

The first adjudication had decided the question of the value of the works up to that point. The second adjudication was in relation to the same question (which is not permitted) and therefore the adjudicator lacked jurisdiction.

SUMMARY

The Court decided that, in the absence of a payment notice or pay less notice, the Employer was taken to have agreed the value stated in the Contractor's application.

This goes beyond what we expected in that it suggests that the value of the works cannot be reassessed on a later valuation.

The Construction Act and JCT contract only provide that, in the absence of a payment notice or pay less notice, the sum stated in the Contractor's application becomes due; they do not suggest that the value of the works also becomes agreed. We understand that the Employer is appealing the TCC's decision; this will, hopefully, clarify the position.

An Employer does not have the right to seek repayment of money paid to a Contractor on the grounds that, at the date of the last interim valuation or at a subsequent date, the value of works was in fact less than that applied for; it cannot seek to revalue the works other than at the valuation dates specified in the contract.

The Employer will only have the opportunity to correct overpayments made at subsequent valuations. It is not, therefore, clear what the position would be if this scenario related to the final account or if (by way of example) the Contractor makes no further applications for payment or if the building contract provides that such overpayments cannot be recovered until settling the final account.

This case highlights the significance of issuing payment notices and pay less notices strictly in accordance with the requirements of the Construction Act and Act-complaint building contracts, especially towards completion of the building works and during any final payment process where there may not be another opportunity to rectify any overpayment.

It is, therefore, of paramount importance that processes are in place to ensure that these Construction Act payment notices are served in the correct form and on time.

NEXT STEPS

If this alert raises any points which you would like to discuss with us or have any concerns relating to the impact of the Construction Act on your business, please contact us. We advise on all aspects of construction contracts and construction procurement.

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