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Construction Law Update

Failure to Give Payment Notices and Pay Less Notices on Time

The recent case of *Kersfield Developments (Bridge Road) Ltd v Bray and Slaughter Ltd* (2017) is one of the latest in a long line of disputes about payment applications becoming due automatically in cases where the paying party has failed to give a payment notice and pay less notice on time or at all.

Background

Kersfield and Bray entered into a JCT Design and Build Contract 2011 with amendments. On 5 August 2016, Bray issued an interim application for payment in the sum of £1,208,279.39 excluding VAT. The last date for issue of a payment notice by Kersfield was 10 August 2016.

On 12 August 2016, Kersfield issued a late payment notice specifying a sum due of £78,224.26. Bray subsequently issued an invoice for that amount, stating "*Any queries we have in relation to the certificate/notice which has been issued will continue but will not hold up our invoice*". Kersfield paid the invoiced sum but did not pay the balance of Bray's application for payment.

The final date for payment was 19 August 2016 and the last date for service of a pay less notice was 14 August 2016. At 9.50pm on Friday 12 August, a pay less notice was served on Bray by email. However, clause 1.7.3A of the contract provided that notices sent by email after 4:00pm on a business day were deemed to have been served on the next business day. Accordingly, the pay less notice was not deemed to have been served until 15 August and was late.

Bray adjudicated against Kersfield to recover the outstanding balance of the sum claimed in their application for payment. The adjudicator decided that Bray's application was valid and that no valid payment notice or pay less notice was given by Kersfield. He ordered Kersfield to pay Bray the balance of the sum claimed in the payment application. Kersfield refused to pay and commenced proceedings asking the court to finally determine the dispute.

Was Bray's application for payment valid?

Clause 4.8.4 of the contract required applications for payment to be "*accompanied by such further information as may be specified in the Employer's Requirements*". The Employer's Requirements stipulated that applications for payment were to include progress reports and full substantiation of all sums claimed.

Bray's payment application comprised a spreadsheet setting out a breakdown of the works, percentage completion and value, materials on site and variations together with a loss and expense claim comprising a narrative, extracts from Bray's Sage records and cost reports from agency resources. Kersfield argued that two sums claimed within the application – being £150,000 for 'disruption' and £307,965 for 'additional labour and supervision' – were not backed up by the required substantiation and that consequently the application was invalid.

The court confirmed that an application for payment must be sufficiently clear and unambiguous in form, substance and intent so that the parties have notice of the application made. However, the court drew a distinction between (i) an application which does not comply with the requirements of the contract and (ii) an application which has individual claims within it that may not be sufficiently substantiated. Applications falling within the second category would not be invalid, although deficiencies in substantiation might justify rejection of some or all of the sum claimed by the issue of a payment notice or pay less notice.

The court found that Bray's application complied with the contract and was valid. It was clearly identified as an application and was accompanied by spreadsheets itemising the sums claimed and the basis on which they were calculated. The court noted that clause 4.8 of the contract did not expressly state that applications are not valid in the absence of supporting information and the purpose of the Housing Grants, Construction and Regeneration Act 1996, as amended (the 'Act') would be undermined if the employer could avoid the requirement to serve a payment or pay less notice simply by challenging parts of a payment application.

Did Bray's invoice stop them from claiming the balance?

Kersfield argued that Bray had adopted the late payment notice as valid by choosing to invoice for the 'notified sum' it had stipulated and were therefore not entitled to contend that the 'notified sum' was set out in their payment application.

The court rejected this argument, finding that Bray had acted consistently and had made clear when issuing the invoice that they were reserving their position with regard to the validity of the payment notice.

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Was the pay less notice valid?

Kersfield argued that clause 1.7.3A of the contract frustrated sections 111(7) (which defines the 'prescribed period' for service of a pay less notice) and 116 (which specifies how time periods are calculated) of the Act. Bray argued that section 115 of the Act (which relates to service of notices) permits the parties to agree on the manner of service of notices.

The court agreed with Bray, finding that clause 1.7.3A of the contract was a reasonable and sensible provision which did not frustrate the provisions of the Act. The pay less notice was therefore out of time according to clause 1.7.3A.

Was Kersfield entitled to start a further adjudication on the substantive merits of Bray's claim for payment?

Both parties accepted that the adjudicator's decision was only temporary in the sense that any alleged overpayment to Bray could be corrected in later interim payments or at final account stage. However, Kersfield argued that it should be entitled to start a further adjudication on the true value of the existing payment application, otherwise Bray would be unfairly entitled to a windfall payment.

The court rejected Kersfield's argument, relying on the line of cases such as *ISG Construction Limited v Seevic College* (2014) and *Galliford Try Building Ltd v Estura Ltd* (2015) as authority for the rule that there is no basis to challenge a 'notified sum' once it has become due. The court stated:

"*… where a particular interim payment has been fixed by the default notice mechanism under the contract, as in this case, there is no contractual basis on which to revise that payment by reference to a proper valuation of the works and therefore there is no relevant dispute that can be referred to adjudication. I acknowledge that the default notice mechanism under the Act might result in unfairness or hardship to an employer in circumstances where the contractor received a windfall from the employer's procedural failure. However, it simply regulates the cash flow as between the parties and does not affect their substantive rights. The employer could protect its cash flow by serving one or both of the notices that could put in dispute the sum claimed by the contractor. This finding does not preclude a challenge to the valuation of the works and/or any claims and cross-claims for the purpose of subsequent interim payments or for the purpose of determining the sums due on a final and conclusive assessment*."

Should judgment in favour of Bray be stayed?

Kersfield's final argument was that a court judgment in Bray's favour should be stayed because Kersfield was not currently in a position to pay the sum awarded by the adjudicator and, if it was later found that Bray had been overpaid, Bray would not be able to pay Kersfield back.

The courts have the power to order a stay of a judgment in certain circumstances. However, the key principle of adjudication is that the winner should not be kept out of its money, so the court will only order a stay when there is no dispute on the evidence that the winner is insolvent and cannot repay any overpayment.

The court examined financial evidence relating to both companies and found that, whilst neither company was in a great financial position, there was no evidence that Kersfield could not get hold of funds to pay the judgment sum and no evidence that Bray would not be able to repay any overpayment if necessary. The court therefore declined to order a stay so that Bray was not kept out of the money it had been awarded by the adjudicator.

Analysis

This is another case which demonstrates to paying parties the importance of serving payment notices and pay less notices on time and strictly in accordance with the requirements of the contract. The courts are very clear in their approach to these types of cases that where the requisite notices have not been served, the paying party must immediately pay the sum which has been applied for and then set about recovering any alleged overpayment by other means. Given the potentially serious financial consequences this can have, it cannot be emphasised enough that paying parties must have a robust system in place for the issue of timely notices.