

Construction Law Update

Validity of Payment Notices and Severability of Adjudication Decisions

In the recent case of *Downs Road Development LLP -v- Laxmanbhai Construction (UK) Limited* [2021], the TCC considered issues concerning the validity of payment notices, as well as questions of natural justice and the severability of adjudication decisions.

Background

Downs Road Development LLP (“DRD”) engaged Laxmanbhai Construction (UK) Limited (“LCUK”) to undertake the construction of four buildings with residential units (the “Works”), under a JCT Design and Build Contract 2011 with amendments (the “Contract”).

Part way through the Contract, DRD adopted an approach of sending two payment notices (or purported payment notices) in each payment cycle. The first would certify a nominal sum and was intended to buy DRD time to ensure “valuations [were] fairly assessed”.

Following Interim Application 34, DRD issued two payment notices. The first, issued within the contractual timetable with a note which stated “we confirm that a further Payment Notice will be issued to you in due course... and this will not affect your payment date,” certified a sum due of 97p (“**Payment Notice 34**”). The second, issued outside the contractual timetable, certified a sum due of c.£660k (“**Payment Notice 34a**”). DRD later accepted that Payment Notice 34a was served out of time and was invalid.

LCUK referred a dispute as to “the correct sum due...in Interim Payment Nr 34” to adjudication, seeking payment of c.£1.3m. DRD raised a set-off defence in its response, alleging that it had suffered loss because of LCUK’s breach of contract in relation to capping beam works.

The adjudicator concluded that his task was confined “exclusively” to the proper valuation of Interim Application 34, and that he did not have jurisdiction to

determine the capping beam contra charge as this had not been mentioned during payment cycle 34. Accordingly, the adjudicator took no account of the capping beam contra charge when determining the amount due to LCUK.

The adjudicator found that the net sum due pursuant to Interim Application 34 was c.£770k and, taking account of deductions/other issues, a sum of c.£100k was ultimately due to LCUK (the “**Decision**”).

LCUK threatened to suspend performance of the Works if payment was not made pursuant to the Decision. This led to DRD commencing Part 8 proceedings seeking a declaration that the Decision was unenforceable by reason of the adjudicator failing to take into account the capping beam contra charge. In response, LCUK sought declarations that DRD’s payment notices were invalid and that the Decision was valid and enforceable.

Issues before the TCC

The key issues for the TCC to consider were:

- (i) the validity of Payment Notice 34;
- (ii) whether the Decision was enforceable; and
- (iii) if the Decision was not enforceable, whether any part of it could be safely severed.

Was Payment Notice 34 a valid payment notice?

The TCC confirmed a valid payment notice had to meet the requirements of the Contract and the Housing Grants, Construction and Regeneration Act 1996 (the “Act”). Namely, such notices had to set out the sum which an employer “genuinely” considered to be “actually” due at the payment due date and the basis on which that sum was calculated. Such requirements were “neither removed nor diminished by the knowledge that the figure may be altered subsequently.”

As it could not be realistically contended that Payment Notice 34 stated the sum that DRD considered to be

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due, or that the same could act as “an agenda for adjudication” as it did not provide any material against which its valuation could be assessed, the TCC held that the same was invalid.

Was the Decision enforceable?

Next, the TCC considered whether the adjudicator’s failure to consider the capping beam contra charge constituted a breach of natural justice rendering the Decision unenforceable.

A deliberate failure by an adjudicator to address a material issue which is before them on a proper view of their jurisdiction will be a breach of natural justice. An adjudicator has jurisdiction to consider any defence which may entitle a party to avoid and/or reduce its liability to pay a sum stated by another party to be due.

By deliberately deciding not to consider the capping beam contra charge, “the adjudicator was declining to address a defence which [DRD] was entitled to advance and entitled to have considered by the adjudicator.” In this regard, the adjudicator adopted an “unduly narrow view” of his jurisdiction and failed to address a significant issue. As the potential set off of the capping beam contra charge was “far from being a trivial part” of DRD’s case, the failure was deemed material. There was therefore a material breach of the requirements of natural justice and the Decision was rendered unenforceable.

Was the Decision severable?

The TCC then considered whether any part of the Decision could be enforced, such as the valuation of Interim Application 34, absent the capping beam set-off.

The TCC noted that the Scottish Court of Session case *Dickie & Moore Ltd -v- McLeish* [2020] was highly persuasive authority and set out the approach that is normally to be taken to determine whether the relevant part of an adjudicator’s decision can be safely severed.

Noting that severing adjudication decisions can be compatible with the policy of maintaining cash flow in the construction industry, the TCC stated that it must nevertheless guard against creating artificial outcomes which could not be the result of a proper decision by an adjudicator.

In this case, severance in the manner proposed would risk turning the Decision into a series of separate decisions. The adjudication concerned a single dispute over the correct sum due pursuant to Interim Application 34 and the Decision addressed that narrow question. In such circumstances, “severance is unlikely to be appropriate and... would involve an artificial division of a continuous chain of reasoning and would create the risk of imposing... an outcome which could not have resulted from the adjudication.”

Accordingly, the TCC refused to sever the Decision.

Analysis

This case provides useful commentary on the well-established legal principles concerning the operation of payment notices and the applicability of the rules of natural justice. In addition, key guidance is provided on the circumstances in which it may be appropriate to sever an adjudication decision and when it will not.

Of additional interest to practitioners may be the TCC’s refusal to definitively conclude whether the invalidity of Payment Notice 34 would give rise to an entitlement to payment on a ‘smash and grab’ basis, given “*matters [had] moved on*” and further interim payments had been made by the time the TCC had handed down its judgment in relation to the same.

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