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The Application of Section 111 to Final Payments

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As discussed in previous editions of Construction Act Review (CAR), the sum due as an interim payment to a contractor is normally the sum that results from the employer's payment notice and pay less notice, if any. But if the employer fails to issue either a valid payment notice or a valid pay less notice, the contractor is entitled to be paid the sum for which it applies. This situation arises as a matter of contract under the JCT Design and Build contract but also as a matter of statute under the Housing Grants, Construction and Regeneration Act 1996 ("the HGCR Act"), as amended by the Local Democracy, Economic Development and Construction Act 2009 ("the LDEDC Act"), under construction contracts generally.[1]

Where the contract does not provide for the contractor to apply for interim payment and payment is dependent on a payment notice from the employer, then in the event of the employer failing to give the notice, the contractor may give its own payment notice which will determine the sum payable, if there is no pay less notice from the employer.[2]

Most construction contracts provide for a final payment as well as for interim payment, following completion of the works. There is often also provision for a final payment to be made following termination of the contract or of the contractor's employment. The question then arises whether the regime described above applies also to final payment. This is a separate issue from the one considered in the writer's recent articles in relation to the case law on successive adjudications.[3] The position is those cases was that the sum due to the contractor was determined in adjudication purely by operation of payment notices, and the issue was whether there could be a second adjudication, on the merits, to determine the correct valuation in accordance with the valuation rules of the contract.

The issue here is whether the sum due to the contractor may be determined purely on notices in the same way for final payments as for interim payments. It is a point on which doubt has been cast in earlier cases, without necessarily being decided.

Doubt over whether s.111 applies to Final Payments

The *Melville Dundas* case[4] was concerned with the relationship between two sets of contractual provision found in the JCT standard forms. First, the contractual provisions based on sections 110 and 111 of the HGCR Act for payment of sums due without withholding, unless there was an effective withholding notice; and secondly, the purely contractual standard provision for no further payment by the employer, in the event of the employer exercising a contractual right to determine the contractor's employment. The majority of the House of Lords (by three to two) gave primacy to the latter provision. The

[1] See ss.110(A) and 110(B).
[2] S.110(B)(2) of the HGCR Act.
[3] *Payment Notices and Successive Adjudications*, (2015) 31 Const. L.J. 41; *Payment Notices and Successive Adjudications Revisited* (2015) 31 Const.L.J. 220; *Payment Notices and Successive Adjudications Update: Harding v Paice in the Court of Appeal* (2016) 32 Const. L.J. 195; *Validity of Payment Notices* (2016) 32 Const. L.J. 510; *Payment Notices and Successive Adjudications Update Part 1*, (2018) Const.L.J 194; *Payment Notices and Successive Adjudications Update Part 2*, (2018) Const.L.J 267.
[4] *Melville Dundas Ltd (In Receivership) v George Wimpey UK Ltd* [2007] UKHL 18 (HL); [2007] Bus. L.R. 1182; [2007] 1 W.L.R. 1136.

circumstances were that the employer was terminating because of the contractor's insolvency, which occurred after the time at which the employer could have served a withholding notice in relation to interim payment due to the contractor.

Since the LDEDC Act, withholding notices are known as pay less notices. The *Melville Dundas* case left open the exact circumstances in which the purely contractual provision had primacy over the contractual provision which had statutory backing. This was addressed in the LDEDC Act, by confining the circumstances to the situation which occurred in *Melivlle Dundas*, *i.e.* a contractual provision for no further payment by reason of insolvency.[5]

The writer gave a full analysis of the *Melville Dundas* case at the time[6] and its relevance to this article is in the form of dicta of Lord Hoffmann and Lord Hope (who were in the majority). Lord Hoffmann stated:

> "In my opinion the concept of a 'final date for payment' in the Act applies only to interim payments."[7]

If there were no final date for payment for a final payment following termination, it could be argued that there was no need to have a withholding notice in respect of such payment, since the timing of a withholding notice was related to the final date for payment. The writer noted at the time that on the wording of s.110(1) of the HGCR Act, it seemed that the concept of a final date for payment applied both to interim payments and any other sum due under the contract ("Every construction contract shall…provide for a final date for payment in relation to any sum which becomes due.") While Lord Hoffmann's dictum was a point of interest, it was not part of the *ratio decidendi* in *Melville Dundas*.

Lord Hope stated:

> "In the light of this background I would give a purposive construction to section 111(1), although it does not contain any obvious ambiguity. The mischief that it addresses is that of the withholding payment without notice of stage payments or other periodic payments (see section 109 (1)), not the withholding of payment of sums already due in the event of the determination of the contractor's employment pending the making up of an account to identify the balance, if any, due to either party once the loss and damage caused to the employer as a result of the determination has been taken into account. The parties' freedom of contract as to the circumstances in which the contractor's employment may be terminated and, if so, with what consequences has not been affected.
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> As the commentator in *Current Law Statutes* indicates, section 111 is primarily designed to reduce the incidence of set-off abuse by formalising the process by which the payer claims to be entitled to pay less than expected by the payee. Construing it in its context, section 111(1) is concerned with the entitlement to stage payments referred to in clause 109. The procedure that applies where an effective notice of intention to withhold payment is given in terms of section 111(4) supports this approach. That subsection envisages that the only issue, if the matter is referred to adjudication, will be whether the whole or part of the amount withheld should be paid and that payment will be made within a very short time thereafter. I agree with

[5] S.111(10) of the HGCR Act, as amended by the LDEDC Act.
[6] *Sections 109, 110 and 111 Revisited: the Melville Dundas Case* (2007) 23 Const. L.J. No 6 444.
[7] *Melville Dundas*, above, at [21].

> Lord Clarke that section 111(1) does not apply to the situation where the employer wishes to exercise the right of set-off that he is given by clause 27.6.5.1 when he has determined the contractor's employment under the contract."[8]

Lord Hope was interpreting section 111 as applying only to interim or stage payments, by reference to the background to the HGCR Act.

A Department of Trade and Industry ("DTI") consultation paper in June 2007 sought views on the likely effect of *Melville Dundas* and whether it gave rise to the need for statutory reform. The DTI paper suggested that s.111 should apply to final payments as well as to payment by instalments and sought views on whether the HGCR Act should be amended to make that clear. In the event, the LDEDC Act did not address that particular concern, but dealt with *Melville Dundas* only as indicated above.

In *Harding v Paice*[9], it was decided, on the successive adjudications issue, that there could be a second adjudication on the correct valuation, where what was at issue was the final payment following termination (not an interim payment). An adjudicator had decided a dispute between the parties as to who had terminated the contract, in favour of the contractor. The adjudicator then decided that the employer was obliged to pay the amount of the final payment applied for by the contractor, in the absence of a valid pay less notice from the employer. He then decided that the employer had not issued a valid pay less notice.

Implicit in the adjudicator's decision (or perhaps explicit, it is not stated in the judgment) is that the provisions for payment following termination of the JCT Intermediate Form (2011) (which included clause 8.12.5) are subject to, but not compliant with, the HGCR Act, as amended by the LDEDC Act, so that the provisions of the Scheme are implied terms of the contract. It is on the basis of these terms that it was decided that the sum in the contractor's account became payable in the absence of a valid pay less notice.

In dealing with the question whether to prevent the second adjudication by injunction, the judge at first instance stated:

> "I should add that I have some reservations about the application of the provisions of the Scheme…to clause 8.12.5 and, in that context, the meaning of expressions such as 'due date for payment' and 'notified sum', but since I have heard no argument on this point I do not propose to say any more about it."[10]

Here it seems that the judge was casting doubt on whether the basis on which the adjudication proceeded, namely that if the employer wished to pay less than the amount in the contractor's account, it had to issue a pay less notice, was actually correct. While the Court of Appeal upheld the trial judge's decision on the injunction, the Court of Appeal did not cast any further light on the question whether s.111 applies to final payments.

The passage quoted above from the judgment appears to be couched in *obiter* terms. Whether this part of the judgment may correctly be regarded as *obiter* is considered in a previous issue of Construction Act Review.[11]

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[8] *Melville Dundas*, above, at [41] – [42].
[9] *Harding v Paice* [2014] EWHC 3824 (TCC).
[10] *Harding v Paice* [2014] EWHC 3824 (TCC) at [37].
[11] Sheridan, *Payment Notices and Successive Adjudications* (2015) 31 Const. L.J. 41.

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The standard form contracts, including JCT, are not drafted with the principle in mind that the final payment following termination is subject to the same statutory rules as interim payment. That may be something that changes in future. At present, there is no reference in these JCT provisions to due and final dates for payment, nor to pay less notices. The JCT and other standard forms do generally have contractual provisions on these matters in relation to the final payment that normally applies where there is no termination. It would seem from this that institutions such as the JCT have not regarded final payments following termination as being subject to s.111 of the HGCR Act.

Adam Architecture

The issue whether section 111 of the HGCR Act applies only to interim payments or whether it also applies to final payments, following completion of the works or termination of the contract, arose squarely for decision in the recent case *Adam Architecture*.[12]

Final payment following termination was again the scenario in the *Adam Architecture* case, as the Court of Appeal found that the architect's appointment was terminated, following which the architect sought final payment of sums due up to the date of termination.

In 2015, Halsbury, a property developer, was proposing to construct 200 homes on land at Loddon in Norfolk. Adam was an architectural practice, engaged by Halsbury in October 2015 to undertake design work in connection with that development, on terms including the RIBA Conditions of Appointment for an Architect (2012 edition) and a fee proposal from Adam consisting of four stages including "develop layout" and "design development".

Adam set to work following its appointment in October 2015, but on 2 December 2015 Halsbury notified Adam that it intended to proceed using a layout provided by another architect. Adam regarded the design of the layout as an essential part of the work Adam had offered to do and took the view that there was no place for Adam on the project, if Adam were having no input on the layout. The layout was also key to the fee proposal which had been accepted. Adam so replied on 2 and 3 December, including with its letter of 3 December an invoice for the work it had undertaken up to 2 December.

Halsbury failed to serve any pay less notice and also did not pay Adam's invoice. Adam started an adjudication claiming the fees invoiced and the adjudicator found in Adam's favour, because Halsbury had failed to serve a pay less notice.

Each party issued proceedings in the Technology and Construction Court. Halsbury sought declarations that the pay less regime did not apply to the December invoice, that Halsbury was not liable to pay that invoice and that the adjudicator's decision was unenforceable. Adam issued proceedings to enforce the adjudicator's decision.

Edwards-Stuart J, the judge in charge of the Technology and Construction Court at the time, held a hearing over two days to deal with both parties' applications. Jackson LJ's only remark on this in the Court of Appeal was:

> "It was obviously sensible case management to deal with both matters at the same time."[13]

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[12] *Adam Architecture Ltd v Halsbury Homes Ltd* [2017] EWCA Civ 1735.
[13] *Adam Architecture*, above, at [28].

Halsbury was seeking declarations that would be final decisions of the court, negating the adjudicator's decision. Coulson J (as he then was, now Coulson LJ) had previously been at pains to stress how rarely it will be appropriate case management to circumvent enforcement of an adjudicator's decision by applying for declarations which will negate the adjudicator's decision.[14] Coulson J was clearly concerned to stem a flow of cases seeking to circumvent adjudicators' decisions in this way. Jackson LJ appears not to share this concern, unless, without saying so, he regarded the case before him as one of those extremely rare cases in which the procedure adopted was appropriate.

At first instance, Edwards-Stuart J found in favour of Halsbury, which entailed finding that although Halsbury did not intend to pay the invoiced sum, it was not contractually required to serve a pay less notice. This was essentially because the invoice was a final account or a termination account and not a "notified sum" as defined in the RIBA Conditions; and therefore not an amount to which the RIBA Conditions concerning pay less notices applied.

On appeal, Adam argued that s.111 applies not only to interim payments during the course of a building contract, but also to payments due under a final account or a termination account when the building contractor or construction professional has completed or ceased work.

Jackson LJ noted that s.109 is expressly limited to interim payments. The same is not true of sections 110, 110A, 110B and 111. These sections, like their headings, talk about "payment", not "interim payment" or some synonym for interim payment. Jackson LJ noted that s.109(4) is also significant, as the word "include" makes it clear that sections 110 and 111 are wider in their scope than s.109. He also stated:

> "There is an important distinction between sections 109 to 110A on the one hand and sections 110B to 111 on the other hand. Sections 109, 110 and 110A set out what a contract must say. If the contract does not comply, then the relevant provisions of the Scheme are incorporated into the offending contract. Sections 110B to 111, by contrast, do not dictate what the contract must say. Instead, those two sections set out, in somewhat convoluted language, what the parties may or must do in certain situations."[15]

Jackson LJ concluded on the language of the statute, both as it was originally and post the LDEDC Act, that section 111 relates to all payments which are provided for by a construction contract, not just interim payments (the same point the writer made in relation to the *Melville Dundas* case at the time). Jackson LJ then turned to the authorities.

He noted first that in the *Rupert Morgan* case in the Court of Appeal,[16] it was common ground that section 111(1) applied to both interim and final certificates. He then turned to the *Melville Dundas* case, stating:

> "In the course of paragraph 21 Lord Hoffmann expresses an opinion that the concept of 'final date for payment' only applies to interim payment. That paragraph contains no discussion about the impact, or lack of impact, of section 111 on final accounts. It does not consider *Rupert Morgan* or the various arguments deployed on the present appeal. Furthermore, that paragraph is not part of the ratio of the decision…

[14] *Caledonian Modular Ltd v Mar City Developments Ltd* [2015] EWHC 1855 (TCC); [2015] B.L.R. 694; [2015] T.C.L.R. 6; 160 Con. L.R. 42.
[15] *Adam Architecture*, above, at [47].
[16] *Rupert Morgan Building Services (LLC) Ltd v Jervis* [2003] EWCA Civ 1563; [2004] 1 W.L.R. 1867.

> Mr Sears [counsel for Halsbury] is on firmer ground when he comes to the speech of Lord Hope. Although Lord Hope does not criticise the concession or the common basis on which both parties argued the appeal [which was that section 111 of the HGCR Act applied to both interim and final certificates], he nevertheless indicates the view that section 111 only applies to interim payments: see [41] – [42]. Mr Sears is correct in that submission, but one swallow does not make a summer. Furthermore, Lord Hope's comments about section 111 do not form part of the *ratio* of the House of Lords' decision."[17]

It is in the writer's view correct that the views expressed by Lord Hoffmann and Lord Hope on this topic were *obiter* and were also wrong.

Although Jackson LJ did then refer to the *Harding v Paice* case in the Court of Appeal, he did not refer to the matters discussed above in relation to *Harding v Paice*, merely noting that both parties in that case accepted that section 111 of the HGCR Act applied to final certificates as well as interim certificates; and that Mr Sears appeared for the employer, as in the present case, but did not seek to argue (either in reliance on *Melville Dundas* or otherwise) that his client could escape from the tentacles of section 111, because that provision only applied to interim certificates.

The Court of Appeal accordingly concluded that section 111 of the HGCR Act applies to both final and interim applications for payment. It is significant for users of standard forms with payment provisions, such as JCT provisions for final payment following termination, which do not expressly set out contractual provisions relating to pay less notices. Until the JCT addresses this, the Scheme steps in to fill in the gaps. The Court of Appeal's decision lays to rest the doubts previously raised, including in the House of Lords in the *Melville Dundas* case. Section 111 applies to all final payments for payment.

The result was that the adjudicator's decision was enforced. The adjudicator in this case awarded £45,490 plus interest and costs (the latter presumably being the adjudicator's fees).[18] It is interesting to speculate why the parties came to adjudicate, then have High Court proceedings with hearings on two days and then go to the Court of Appeal (both parties for this occasion engaging different and more senior counsel than in the High Court) over such a small sum and what their net losses may have been.

[17] *Adam Architecture*, above, at [59] – [60].
[18] *Adam Architecture*, above, at [25].