

COURT GUIDANCE ON PAYMENT APPLICATIONS, PAY LESS NOTICES AND LEVYING OR DEDUCTING LIQUIDATED DAMAGES

On 14 August 2015, the Technology and Construction Court provided guidance, in the case of *Henia Investments Inc v Beck Interiors Limited*, on payment applications, the content of pay less notices and pre-conditions to an employer deducting or claiming liquidated damages (LADs) in the context of a JCT Standard Building Contract (2011 edition).

The guidance is of interest to anyone entering into or administering building contracts.

KEY POINTS

- ◆ A contractor's application for payment will only be effective if it is clear and unambiguous which due date it relates to.
- ◆ A pay less notice is not limited to dealing with set offs (such as LADs). It can act as a revaluation by the employer of the works.
- ◆ Compliance by the contract administrator (the CA) with the timescales for reviewing a contractor's application for an extension of time is not a pre-condition to a right to deduct or claim LADs.

CLARITY IN PAYMENT APPLICATIONS

Under the JCT Standard Building Contract (2011 edition), the employer is obliged to pay the full sum applied for by the contractor if the contractor submits a valid payment application and there is no interim certificate issued by the CA or pay less notice issued on behalf of the employer. This is regardless of whether or not the contractor is properly entitled to the sum it has claimed in the application for payment.

Unfortunately, contractors often submit documents which do not make it clear that they are intended by the contractor to be applications for payment and/or do not make it clear which due date they are intended to relate to. This makes it very difficult for employers to know if and when they must serve pay less notices.

In the *Henia* case, the court made it clear that if a document submitted by the contractor is to take effect as an interim application it "... must be clear ... so that the parties know what to do about it and when". Whilst it is not absolutely necessary that the relevant due date is referred to in any application "... it must be clear and unambiguous that an application relating to a specific due date is being made".

If it is not clear and unambiguous what due date the application for payment relates to, the application will not take effect as a valid interim application.

However, if the employer is in any doubt about whether or not an application for payment by a contractor is valid, the employer should serve a pay less notice in order to protect its position. That is precisely what Henia did in this case and the court made it clear that Henia's pay less notice would have prevented Henia from having to make any payment to Beck had Beck's application for payment been determined to be valid.

PAY LESS NOTICES

If an employer wishes to pay less than:

- ◆ the amount the CA has stated is due in an interim certificate; or
- ◆ (if the CA has not issued its certificate on time or in the correct format) the amount applied for by the contractor,

a pay less notice has to be served on the contractor within the required timescales.

Both the Housing Grants Construction and Regeneration Act 1996 (as amended) and the JCT Standard Building Contract (2011 edition) require the pay less notice to set out the sum that the employer considers to be due on the date the notice is served and the basis on which that sum is calculated.

In the *Henia* case, Beck argued this meant that the notice could only be used to deduct sums (such as LADs) from the amount stated as due in the CA's certificate or the contractor's application. As a result, it was claimed by Beck that the pay less notice served on behalf of Henia, which contained a new valuation of the works, was invalid.

The judge disagreed with Beck. Pay less notices are not limited to deductions such as LADs. They can also include the employer's valuation of the works.

LIQUIDATED DAMAGES

In order to deduct or claim LADs under the JCT Standard Building Contract (2011 edition):

- ◆ the CA has to give the contractor a non-completion certificate; and
- ◆ the employer has to notify the contractor that it intends to deduct or claim LADs.

In the *Henia* case, Beck argued that compliance by the CA with its obligation to determine within 12 weeks any application made by the contractor for an extension of time was also a pre-condition to being able to deduct or claim LADs. Whilst the court did not need to deal with this point because an adjudicator had already determined that the CA had complied with its obligations, the court set out its views on this issue given the importance of it to the wider industry.

The court rejected the contractor's argument – an employer can deduct LADs even if the CA has not determined an application for an extension of time within the timescales set out in the contract.

Whilst it may be "*unfair on the Contractor to have liquidated damages deducted at a time when the CA has failed to deliver the process of considering extension of time claims*" the contractor is not without a remedy. It still has the ability to establish its extension of time entitlement by adjudication in the short term and either litigation or arbitration in the long term.

IMPACT

- ◆ If contractors follow the guidance given by the court, employers should receive applications for payment which clearly identify which due date they relate to. This will make it easier for employers and those assisting them with payment processes to know whether an application has been made in time and when notices responding to that application should be sent to the contractor.
- ◆ If contractors do not follow the guidance given by the court, their applications for payment will not be effective and so will not result in any payment being due from the employer.
- ◆ Employers and those issuing notices on their behalf now have the comfort of knowing that pay less notices which amount to a revaluation of the work are valid.
- ◆ LADs can be deducted or claimed even if the CA has not responded to an application for an extension of time within the timescales required by the contract. However, CAs should still comply with the timescales for dealing with claims for additional time in order to ensure that LADs are not deducted where an extension of time is justified.

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