When Will You PAY ME?

My office at 218 Strand is just a few yards away from the church of St Clement Danes.

The bells of the church are famous for opening the nursery rhyme "Oranges and Lemons", and you can often hear them tolling out the tune today.

I am guessing that there are not many of us in the room today who make a living selling oranges and lemons. And none of us could charge five farthings (about half a penny in decimal currency) even if we were as generous as the bells of St Martin's. But I am sure that every one of us has at some point asked the question posed by the bells of Old Bailey, "When will you pay me?" And I daresay that a few of us have had the answer of the bells of Shoreditch given to us: "When I grow rich" (possible translation: when my client pays me).

This talk will give a brief overview of what your legal rights are as professionals in the construction industry if your client delays making payment to you. As I am sure that most of you will be familiar with these rights, at least in general terms, I will devote the bulk of my time to the options available to you, and to the clients and contractors whose contracts you may be administering, when these rights are infringed. I shall offer some insights from my experience of guiding clients through the available processes for securing payment, and explain how they can be used efficiently and cost-effectively.

1. The Law

1.1 Payments must be made in stages

The common law of England and Wales does not guarantee the right which many in the construction industry now take for granted. Early cases[1] which remain the basis of our contract law required that the receiving party give the paying party an entire performance to be entitled to any payment at all. The requirement to make payment in stages has been included in standard industry forms for a long time and more recently it has been made an implied term in "construction contracts" as defined by the Housing Grants, Construction and Regeneration Act 1996.

If you are dealing with a contract that is not expected to take very long to perform, and you want payment to become due when the job is done and not before, then you can:

> (a) Agree upon or specify an estimate of less than 45 days in which the contract is to be performed[2], or
>
> (b) Identify the subject matter of the contract as a dwelling which the employer occupies or intends to occupy as his residence[3].

This would put the contract outside the scope of the Act. It would then be a matter of commercial bargaining when any payments were made, and on what terms. The judges in *Cutter v Powell* were influenced by the fact that the second mate had agreed a higher-than-

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[1] Notably *Cutter v Powell [1795] EWHC KB J13* – see http://www.bailii.org/ew/cases/EWHC/KB/1795/J13.html
[2] Housing Grants, Construction and Regeneration Act 1996, Section 109(1) – see http://www.legislation.gov.uk/ukpga/1996/53/section/109
[3] Housing Grants, Construction and Regeneration Act 1996, Section 106 - see http://www.legislation.gov.uk/ukpga/1996/53/section/106

normal fee for completing the voyage from Jamaica to Liverpool than he would have received if he had been paid at prevailing rates, and so a generous payment on completion, coupled with a condition precedent that the works be complete before payment is made, may still prevent a contractor seeking a *quantum meruit* payment if the work is not finished.

If you are dealing with a significantly longer contract, then it is advisable to agree terms for stage payments expressly. This can be by adopting a standard industry form, or by negotiating bespoke terms. Otherwise the payment provisions of the Scheme for Construction Contracts attached to the 1996 Act (as amended in 2009) will be implied into the contract[4].

1.2 There must be an adequate mechanism for stage payments

The Act imposes its own scheme for stage payments, not only where there is none in a qualifying construction contract, but where the one agreed by the parties is inadequate[5]. The safe approach here is to use one of the particular industry standard forms, as these have provisions for stage payments which comply with the Act. The "adequacy" of a payment mechanism is not dependent solely upon whether it is clear or workable, but on whether it meets certain criteria prescribed by the Act.

If a bespoke stage payment regime is used, then the Act allows the parties plenty of freedom to choose how the payments in stages will be made[6]. Difficulties tend to arise where payment is made conditional upon some event occurring under another contract. Section 142 of the Local Democracy Economic Development and Construction Act 2009, which amends the 1996 Act, cites some specific instances:

142 Determination of payments due

(1)In the Housing Grants, Construction and Regeneration Act 1996, section 110 (dates for payment) is amended as follows.

(2)After subsection (1) insert—

"(1A)The requirement in subsection (1)(a) to provide an adequate mechanism for determining what payments become due under the contract, or when, is not satisfied where a construction contract makes payment conditional on—

(a)the performance of obligations under another contract, or

(b)a decision by any person as to whether obligations under another contract have been performed.

(1B)In subsection (1A)(a) and (b) the references to obligations do not include obligations to make payments (but see section 113).

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[4] For the text of the terms implied, see http://uk.practicallaw.com/cs/Satellite?blobcol=urldata&blobheader=application%2Fpdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1247377158027&ssbinary=true

[5] See Housing Grants, Construction and Regeneration Act 1996, Section 110 http://www.legislation.gov.uk/ukpga/1996/53/section/110 and Local Democracy, Economic Development and Construction Act 2009, Section 142 - http://www.legislation.gov.uk/ukpga/2009/20/section/142 and Section 143 - http://www.legislation.gov.uk/ukpga/2009/20/section/143

[6] See Housing Grants, Construction and Regeneration Act 1996, Section 110(1)

(1C)Subsection (1A) does not apply where—

(a)the construction contract is an agreement between the parties for the carrying out of construction operations by another person, whether under sub-contract or otherwise, and

(b)the obligations referred to in that subsection are obligations on that other person to carry out those operations."

(3)After subsection (1C) (as inserted by subsection (2) above) insert—

"(1D)The requirement in subsection (1)(a) to provide an adequate mechanism for determining when payments become due under the contract is not satisfied where a construction contract provides for the date on which a payment becomes due to be determined by reference to the giving to the person to whom the payment is due of a notice which relates to what payments are due under the contract."

The idea of the amendments is that it is okay to make payment under a main contract conditional upon performance of subcontracted obligations, but not to make the subcontractor's payment conditional upon approvals by the employer's agent under the main contract, or indeed upon the employer's or the main contractor's performance of their obligations under the main contract.

The dates upon which payment becomes due in stages must also be fixed in the contract, and not subject to change at will by the employer notifying different dates.

If the contract terms fall foul of these provisions, then as before, they will be displaced by the relevant payment terms in The Scheme for Construction Contracts (as amended)[7]. This can result in a party committing serial breaches of contract, because they do not realise what terms actually apply to their contract. A "smash-and-grab" (so-called) adjudication on an invalid or ineffective payment or pay less notice could be the result.

One common provision in bespoke contracts which we routinely challenge seeks to make any payment at all contingent upon the provision of collateral warranties bonds or guarantees. As the warranty, bond or guarantee is given by a third party, they can in theory interfere with the stage payments under the contract by refusing to give one. So far, however, we have not had to issue a challenge for non-payment on these grounds.

1.3 No "Pay-when-paid" clauses

This is another contingency which was outlawed under the 1996 Act[8], subject to certain exceptions, mainly where an insolvency was involved.

Of course, as most of us in this room will be aware, main contractors will generally look for reasons not to pay for work for which they have not been paid by their employer, regardless of the legislation. They just have to think of other excuses for not doing so besides the straightforward one that they have not been paid. There will normally be a reason for the

[7] For the text of the terms implied, see http://uk.practicallaw.com/cs/Satellite?blobcol=urldata&blobheader=application%2Fpdf&blobkey=id&blobtable=MungoBlobs&blobwhere=1247377158027&ssbinary=true

[8] Housing Grants, Construction and Regeneration Act 1996, Section 113 - see http://www.legislation.gov.uk/ukpga/1996/53/section/113

non-payment by the employer, and it may be a valid reason to withhold payment under the subcontract also, provided that it is notified in time.

There may, however be commercial reasons why the main contractor does not want to put pressure upon the employer to make payment which have nothing to do with the particular subcontractor who is seeking his stage payment. At that point, the QS or other professional who is administering the subcontract may have to be a little creative in his assessment of the subcontractor's account. Or commercial pressure to accept what is on offer may simply be applied.

The tricky situations, which often find their way to us, involve either outright insolvency, or cash flow issues which are leading a particular party in that direction. The Act allows payment to be withheld where there is a relevant insolvency which could prevent the main contractor from ever being paid[9]. I have had to deal with a dispute where the subcontractor had undoubtedly done the work and supplied the goods for which he was seeking payment, but under his contract, the insolvency of a particular party connected to the employer was used by the main contractor to justify withholding payment. The wording of Section 113(1) of the Act is rather opaque, however, even to lawyers, and the contract in this case simply reproduced the wording verbatim: arguably, it is necessary also to identify any third parties (usually a funder) payment by whom is a condition of payment by the employer under the main contract, otherwise payment by the third party is not a condition "under the contract".

1.4 No "Pay when certified" clauses

The 2009 Act sought to ensure that payments could not be "stalled" by saying that a certificate was awaited either under the main contract or under the subcontract itself[10].

This is not to say that those certificates cannot determine the amount that is properly due under a contract, they simply cannot determine when a stage payment (of whatever amount) becomes due.

Before then, it was a relatively easy way to get around the "pay-when-paid" provisions to say that payment had not been certified by the employer, or by the contract administrator, even where work and materials had clearly been supplied. There was always the possibility to argue that the main contractor himself was the victim of the employer's bureaucracy.

The problem persists, however, particularly with variations. These can be instructed for any number of reasons – sometimes in haste, to meet an eventuality on site, with the paperwork having to be tidied up afterwards. The work is done; the materials supplied; but in a chain of contracts, it can take time for professionals away from the site to authorise payment by the employer.

The problem with variations can be working out why they were needed. In the case of a charge of mind by the employer, which is instructed down the contractual chain, there is

[9] Housing Grants, Construction and Regeneration Act 1996, Section 113(1) – see http://www.legislation.gov.uk/ukpga/1996/53/section/113

[10] See Local Democracy, Economic Development and Construction Act 2009, Section 142, quoted in full above.

little room for argument. Where the instruction is given verbally on site by a project manager, and has to be carried out before time specification and price can be documented and set up the line, the situation may be quite different. The employer, and the QS acting for him and for the main contractor, may well suspect that the need for the variation arose through the fault of one of the trades (not necessarily be one that carried out the varied work), and investigation time may be taken to find out where responsibility lay.

1.5 No set-off or abatement

The idea behind these provisions is to make it more difficult for the paying party to put an unproven claim for breach of contract on an even footing with an entitlement to a stage payment for work shown to be completed in accordance with the contract.

Set off is where a claim for a sum of money, as a debt or as damages, is deducted from a sum otherwise accepted to be due and payable. Abatement is where the sum claimed to be due and payable is reduced because of some alleged shortcoming in the work or services for which payment is claimed. The net effect of both is the same; the receiving party is denied part or all of a sum claimed for work and materials provided on the strength of claims or criticisms which they may hotly contest.

Prior to the 2009 Act[11] coming into force, it was possible to abate a claim for a stage payment without serving a withholding notice specifying this as a reason for withholding payment; now, any abatement, set off or counter-claim has to be specified in a pay less notice, or else the receiving party's application for payment has to be met in full, with argument to follow later about other issues.

As with pay-when-paid/certified, the tightening of the legislation has not stopped employers from asserting set-offs and applying abatements. If anything, it has made them more careful to ensure that deductions of this kind are picked up and included in pay less notices. In practice, although the receiving party has the right to challenge questionable set-offs or abatements on their merits in adjudication, contractors and sub contractors remain reluctant to launch adjudications in the middle of a job. They may not have either the financial or the manpower resources to argue such a case properly whilst continuing to work.

2. The Processes

2.1 Suspension of work is a very natural reaction to failure to make proper payment for work which has already been done. It is a right guaranteed by statute: The 1996 Act requires that construction contracts include an express right to suspend work for non-payment[12], and where no such right is included, one is implied into the contract. The exercise of the right is subject to strict conditions, however and the need to comply with these carefully justifies the description of suspension as a process.

[11] Local Democracy, Economic Development and Construction Act 2009, Section 144 – see http://www.legislation.gov.uk/ukpga/2009/20/section/144

[12] Housing Grants, Construction and Regeneration Act 1996, Section 112 – see http://www.legislation.gov.uk/ukpga/1996/53/section/112

I have been asked a number of times to draft notices to suspend on behalf of clients. (I have occasionally had cause to draft them on behalf of my own company). If they are on larger projects with bespoke contracts, then the right to suspend is generally hedged around with dire warnings about the losses that the employer will seek to contra-charge if the right is held to have been exercised improperly. The suspending party is entitled to their costs of de-mobilisation and re-mobilisation if the right is exercised correctly[13], but the upfront costs of these together with the risk of becoming liable for employer's losses as well if the suspension is held to be wrongful are frequently a powerful commercial disincentive for contractors and subcontractors to go down this route.

There is a saying, however, that the threat is often more powerful than its execution. The process leading up to suspension of work is designed with this in mind. Notice must be given of intention to suspend 7+ days in advance of any actual suspension, giving the reasons why suspension is being threatened[14]. The employer therefore has some time to sweat over the possible consequences before the risks accrue for the suspending party.

2.2 Negotiation and mediation

Many bespoke contracts, and some standard forms as well, have express clauses providing for negotiation, mediation and some other form of non-binding Alternative Dispute Resolution (ADR) process to take place before matters are submitted to a third party for a binding decision.

In pure contractual terms, most of these clauses are impossible to enforce, because the rights to suspend and to go to adjudication cannot be qualified beyond what the Act allows.

The courts do, however, encourage the use of ADR – especially mediation and negotiation pre-issue of proceedings – and can stay proceedings, impose cost penalties, and even dismiss claims where the parties have not attempted this[15].

The difficulty, even when the parties have agreed to use the process in their contract, is the essentially consensual nature of the process itself, and any outcome that may be hoped for from it. A meeting date has to be set, a venue agreed upon, decision makers' diaries vacated, any mediator appointed and paid for, and a willingness to compromise on at least one and usually both sides found on the day. All this between parties who are in dispute.

Nevertheless, disputes between parties to a construction contract are by definition between parties who have proved capable of negotiating an agreement already – the contract they are working under – albeit that there may have been a significant imbalance of bargaining power, which will most likely be reflected in the stance taken by the parties in any dispute

[13] Local Democracy, Economic Development and Construction Act 2009, Section 145 (3) – see http://www.legislation.gov.uk/ukpga/2009/20/section/145

[14] Housing Grants, Construction and Regeneration Act 1996, Section 112 (2) – see http://www.legislation.gov.uk/ukpga/1996/53/section/112

[15] Notably in *PGF II SA v OMFS Company ltd [2013] EWCA Civ 1288*, in which LJ Briggs said the defendant's refusal to respond to an invitation to mediate amounted to unreasonable conduct. The defendant was then penalised through a costs sanction upheld by the court – see http://www.bailii.org/ew/cases/EWCA/Civ/2013/1288.html

under this agreement. Hence there is always an instinct amongst commercial parties to try negotiation when there is disagreement. Sometimes where there is also frustration and a build-up of bad feeling, a third party neutral can help keep the negotiating impulse alive.

2.3 Adjudication

Some of you in the room will be aware that before statutory adjudication was introduced in the 1996 Act[16], the Architect, Engineer or Contract Administrator held the balance between the employer and the contractor under most standard forms of contract. Although exercising professional judgement in an objective and impartial way, the certifier was normally appointed, and paid, by the employer. There was thus an incentive for him or her to give the employer the benefit of the doubt – not least because over-certification could give rise to a breach of contract or negligence claim against them.

The adjudication process – available at any time under a construction contract – gave contractors the chance to appoint a professional who was not part of the employer's team, jointly with the employer, to give an outside view on any dispute between them under the contract. The decision of this person trumped any certification by the architect, engineer or contract administrator under the contract. The adjudicator was given investigative powers by the Act[17] – this was part of the compulsory job specification that was implied into any construction contract – so he did not need to require the referring party to lead expert evidence and pay for submissions by top lawyers. He or she could ascertain the relevant facts and law him or herself and make a decision upon these findings. This led to a significant shift in power between contractors and employers, with the latter now finding that the contractor could ride a coach and horses through any contrived excuses for low payment on interim applications for payment to preserve cash flow.

Unsurprisingly, on the larger projects, where the employer is generally able to dictate terms to the supply chain, there have been steps taken to redress this balance the employer's way. The right to adjudicate cannot be taken away as it is guaranteed by statute, but the motivation to adjudicate has been addressed by the introduction of Independent Certifiers who are not otherwise involved in the project, and who have comparable powers and bases of remuneration to adjudicators. There were also attempts made to compel the contractor to pay the costs of the adjudication – his own, the employer's, and the adjudicator's – regardless of the outcome of the adjudication.

The latter measures were expressly outlawed by the 2009 Act[18] but one still encounters them in contracts (especially sub-contracts), usually dressed up as agreements to indemnify the employer for any costs incurred in responding to an adjudication.

As architects', engineers' and surveyors' professional appointments are normally construction contracts for the purpose of the 1996 Act[19], they too must contain adjudication

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[16] Housing Grants, Construction and Regeneration Act 1996, Section 108 – see http://www.legislation.gov.uk/ukpga/1996/53/section/108

[17] See Housing Grants, Construction and Regeneration Act 1996, Section 108 (2)

[18] Local Democracy, Economic Development and Construction Act 2009, Section 141 (2) – see http://www.legislation.gov.uk/ukpga/2009/20/section/141

provisions. This is fine if the professional concerned is seeking swift payment of overdue fees, but the employer can also use the adjudication process to run a claim for professional negligence in 28 days[20]. Professionals and their PI insurers have reacted with indignation in my experience when this is done, but there is little that they can do about it, and the adjudicator delivers a binding (but not final) decision within the time allowed.

The problems with adjudication for its users are (i) that normally both sides must pay their own costs regardless of the outcome (the loser usually has to pay the adjudicator's costs), and (ii) the decision is not final, so the dispute can be revisited in court or in arbitration. The Late Payment of Commercial Debts Regulations 2013[21] have had some impact on (i). The costs risk perceived with (ii) usually deters further action, but I have successfully re-litigated issues for clients which were lost in adjudication.

2.4 Arbitration

The statutory adjudication process was introduced in part because arbitration – which had been the "traditional" private process for resolving disputes in the construction industry – was becoming as slow and expensive as litigation in the courts.

The legislation was updated around the same time as the statutory adjudication process was introduced. The Arbitration Act 1996[22] updated the domestic Arbitration Act 1950[23], which has remained a model for arbitration in some commonwealth jurisdictions. The broad approach of both statutes is the same, however: the parties are given wide freedom to choose their own procedural and substantive law, seat of the arbitration, and procedural rules, with the Act supplying default provisions where key mandatory terms are not covered, in the same way as the Scheme for Construction Contracts does for adjudication[24].

The standard forms of construction contract have separate articles covering arbitration and litigation, and in the Contract Particulars, ask the parties to indicate whether they opt for arbitration or litigation as a final dispute resolution process. There must be a positive choice for arbitration, as it must be agreed by both parties, otherwise the court retains final jurisdiction. If the parties have different views on whether the court or an arbitrator has jurisdiction over their dispute, then the Act gives them the option to ask either an arbitrator or the court to settle this point[25].

Among the attractions of arbitration are the following:

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[19] Housing Grants, Construction and Regeneration Act 1996, Section 104 (2) – see http://www.legislation.gov.uk/ukpga/1996/53/section/104

[20] Housing Grants, Construction and Regeneration Act 1996, Section 108 (2) – see http://www.legislation.gov.uk/ukpga/1996/53/section/108

[21] Late Payment of Commercial Debt Regulations 2013 – see http://www.legislation.gov.uk/uksi/2013/395/pdfs/uksi_20130395_en.pdf

[22] Arbitration Act 1996 – see http://www.legislation.gov.uk/ukpga/1996/23/contents

[23] Arbitration Act 1950 – see http://www.legislation.gov.uk/ukpga/Geo6/14/27/contents

[24] The Scheme for Construction Contracts (England and Wales) Regulations 1998 – see http://www.legislation.gov.uk/uksi/1998/649/schedule/part/I/made

[25] Arbitration Act 1996, Sections 31 and 32 – see http://www.legislation.gov.uk/ukpga/1996/23/part/I/crossheading/jurisdiction-of-the-arbitral-tribunal

i) It is private – proceedings are not conducted in public, and arbitrators' awards are only published to the parties;
ii) The arbitrator will usually be chosen – by the parties or by a nominating body – for his or her expertise in the matters in dispute, unlike a judge who may have no particular technical expertise, even in the specialist branches of the High Court like the Technology and Construction Court;
iii) The arbitrator's fees are paid by the parties, which is an extra expense for them, but it does mean that arbitrators tend to be more considerate and flexible to accommodate the parties' needs than judges and court staff tend to be;
iv) The arbitrator manages the case throughout, so there is less danger of inconsistency of approach than in the courts, where different judges may make orders as the case progresses;
v) There is considerable freedom, which private commercial parties expect, to set the rules in advance and to agree any appropriate changes to them later on, as the arbitrator's jurisdiction derives from their contract, not from the general law;
vi) There is a lot of support, through a network of international treaties[26], for the enforcement of arbitral awards in many different countries.

If you have done work under a contract and are seeking to enforce payment, however, there are also a number of reasons why you might not want there to be an arbitration clause in your contract:

i) They can be considered to be unfair terms in a consumer contract. If there is an arbitration clause in such a contract, the commercial party seeking payment may not know whether it can rely upon the clause. As a result, it may not know whether to commence court proceedings or an arbitration;
ii) There can be significant delay in having substantive matters determined if the parties have left their choice about key matters such as the seat of the arbitration and the applicable law unclear in the contract, especially if they are domiciled in different jurisdictions and each advance a claim for their own convenient forum for proceedings;
iii) There can be difficulty getting an arbitration started if one party refuses to cooperate, as the arbitrator may be concerned to have an agreement with both parties in order to safeguard payment of his fees, and indeed to establish his jurisdiction to deal with applications from both parties;
iv) The arbitrator's award can be registered and enforced as a judgment of the court[27], but this is a further step which has to be taken, and exposes the process of obtaining the award to scrutiny by the court;
v) Arbitration can often work out more expensive than court, as the arbitrator charges fees, there are costs of the venue for any hearing, and as noted above it can give rise to procedural issues which generate extra cost;
vi) The appointment of an arbitrator is a personal appointment, and so if the arbitrator dies or becomes too ill to continue, you have to start again with someone else.

[26] Notably the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 – see http://www.newyorkconvention.org/11165/web/files/original/1/5/15432.pdf
[27] Arbitration Act 1996, Section 66 – see http://www.legislation.gov.uk/ukpga/1996/23/section/66

2.5 Litigation

The court is still the process which trigger-happy unpaid parties most readily think of as a solution to their plight.

As someone once remarked when reflecting upon why alternative methods of dispute resolution were not everybody's cup of tea, "Clint Eastwood swaggered into town with his six-shooters saying, "I'm here for justice!" not "I'm here for compromise!""

The court is still the gold-standard when it comes to justice. The association of alternative methods of dispute resolution with compromise can communicate the idea that they are second- or third-rate. The Overriding Objective of the Civil Procedure Rules – brought into force like the adjudication and arbitration statutes referred to above at the end of the 1990s[28] – is stated to be to "enable the court to deal with cases justly and at proportionate cost."[29]

The reality of the Civil Procedure Rules, however, is that they put a lot of pressure upon parties to attempt DIY justice in order to achieve the second part of the Overriding Objective, which is to keep costs proportionate to the sums at stake.

The Rules require parties, before they even start most types of proceedings, to discuss their claim directly with each other in compliance with the relevant pre-action protocol[30]. The protocols prescribe in general terms the information that the parties should provide to each other. They then encourage the parties to meet on a without prejudice basis, or to attempt some form of alternative dispute resolution, to see if the matter can be settled before it is brought to court.

Although the Rules provide this barrier to accessing the court process, to court system itself has made access much easier for litigants by setting up an online service for money claims at www.moneyclaim.gov.uk. Claimants can register on this website, put in a few details of their claim, pay a court fee with their credit card, and the County Court Money Claim Centre (CCMCC) in Northampton will issue a Claim Form to their opponents. The prospect of having a county court judgment (CCJ) entered against them which will affect their credit rating then looms large for the defendant party.

Arranging for your opponent to receive a Claim Form is certainly a step up from sending them a solicitor's letter demanding payment. And it can work: a client of mine who repeatedly ignored my requests for him to settle an overdue bill settled it immediately once he received a Claim Form from the CCMCC. There are pitfalls, however, to be aware of.

The first is that if the Defendant does overcome the initial shock of receiving a Claim Form and files a Defence, then any failure to comply with the pre-action protocol can result in the

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[28] Civil Procedure Rules 1998 – see http://www.legislation.gov.uk/uksi/1998/3132/contents/made

[29] Civil Procedure Rules, Part 1 - Overriding Objective - see https://www.justice.gov.uk/courts/procedure-rules/civil/rules/part01

[30] Civil Procedure Rules, Practice Direction – Pre-Action Conduct and Protocols – see https://www.justice.gov.uk/courts/procedure-rules/civil/rules/pd_pre-action_conduct

claim being stayed quickly by a judge. The parties are then sent away to comply with the pre-action protocol, and are unable to continue before the court until they have done so. The Claimant may then have wasted the court fee for issuing the claim if the claim is settled.

The second is that the Claim Form and any Particulars of Claim still have to comply with the Civil Procedure Rules, or risk being struck out. The money claim website does help to formulate Claim Forms by prompting its users for the appropriate information, but it cannot do this for the Particulars of Claim, which are peculiar to every case. The Rules do however have specific requirements for different types of claim, including breach of contract claims, and these are well hidden away in Practice Directions[31].

The third is that you are exposing yourself to liability to pay your opponent's costs if they have a complete defence to the claim. A complete defence can be a set-off or counterclaim. One of the aims of the pre-action protocol is to ensure that all the parties to a potential action are aware of all the issues that are likely to come up in that action; missing out the pre-action protocol can thus lead to a Claimant being taken by surprise by a Defence.

The majority of disputes still do settle before they get to the final shoot-out before the judge, with the potential for a winner-takes-all outcome, and sometimes also the financial annihilation of one or more of the parties.

The construction industry is rich in alternatives to the court process which retain some attempt to assess the justice of the case, however roughly, and do so quickly and at a realistic cost.

3. The War Stories

In view of the weight of law and legal process that stands behind parties seeking payment in the construction industry, the party resisting making payment needs to be pretty sure of their reasons for withholding it, and pretty clear in setting them out at the required times.

There are three common themes we see in the reasons given as to why paying parties do not want to pay some or all of the payments sought from them, or want to get back sums that they have paid. The first is that they question the quantity of work done, the second that they allege some breach of contract or negligence which gives them a set-off or counterclaim, and the third is that they allege some fraud on the part of the other party. Some paying parties try all three.

In the remainder of this talk, I shall recall a few "war stories" based around sub-themes arising under these three broad headings.

3.1 Quantity of Work

3.1.1 Was the work properly authorised under the contract?

[31] Civil Procedure Rules, Practice Direction 16 - Statements of Case, Paragraph 7 – see https://www.justice.gov.uk/courts/procedure-rules/civil/rules/part16/pd_part16#7.1

I have had to deal with this issue in justifying my own work to insurance companies, barrister's and expert witness's work to solicitors and their client, subcontractor's work to main contractors, and main contractor's work to the client.

All parties who employ someone under a contract for services tend to want a certain outcome in a certain time for a certain amount of money. The amount of effort that is required to achieve the outcome is circumscribed by the time available and the budget. Provided it is done with the originally specified outcome in mind, and within the agreed timeframe, the precise quantity of work or effort required in terms of hours may be immaterial to the parties.

The problems arise when either the price is not fixed at all but linked to the actual time taken, or it is fixed, but subject to additions when extra time and/or a modified outcome is required.

In order to safeguard the budget, and the planned completion date for the work, the paying party may require such work to be authorised before it is undertaken, so that all options can be considered, such as omitting some work.

Or as in the case of the insurance company, they may insist upon authorising work up to a certain value, without really going into the practicalities of doing just that much work and no more before coming back for fresh authorisation.

Standard form contracts which are professionally administered by a contract administrator will generally require the contract administrator to authorise any variations to the originally agreed scope of works. Questions often arise as to what happens when someone else "authorises" a change in scope. Typically in refurbishments of domestic properties, it will be the lady of the house who changes her mind about what she would like as work progresses, and tells the contractor to depart from the specification. The claim for variation costs and extra time comes as something of a surprise to the contract administrator and the client.

Letters of intent try to have the best of both worlds, by signing the contractor up to the standard form contract with its fixed scope of works and programme, but without committing to the full contract price straightaway. We have seen significant frustration amongst subcontractors where mock-ups and design work are carried out, and slots in factories booked, only for the full contract to be awarded to another party when the subcontractor seeks to include all the effort that he has undertaken in the contract price. There can also be confusion over whether there is a contract at all if a letter of intent is used and then repeatedly extended until the project is well advanced if not completed.

One dispute we have dealt with involved a project manager effectively being turned into a main contractor when the client's intended main contractor failed to materialise. The project management agreement naturally did not make provision for acting as main contractor. The result was a protracted dispute between the client and the project manager-cum-main contractor over whether or not a fixed fee applied to his appointment.

Some of you may have acted as expert witnesses in court. One of our clients acted as a programming expert in the Technology and Construction Court, and the work required went well beyond the costs estimates he provided to the solicitors. In spite of the eagerness of the solicitors and their client for him to press on during the case, he still had to demonstrate that the amount of work carried out was reasonable, and he was not helped in this by some criticism from the court.

3.1.2 Is the work evidenced as the contract requires?

One of the problems the Construction Act[32] sought to address was the difficulty some contractors had in getting paid for work they had done, but which might not have been evidenced in precisely the way stipulated by the contract.

Professional contract administrators assessing a contractor's claim for payment must apply the terms of the contract. The rates and the quantities for variations instructed in haste on site to deal with contingencies as they arise can be particularly vexed areas. The nature of the work required, and its cost, may only become apparent as it is done.

The extension of time and loss and expense provisions in most standard form contracts provide latitude to reach a sensible agreement on such matters. However, where the contact is part of a chain of contracts, the timing of the request can be critical for the paying party, who then has to seek payment up the line. As a result, bespoke adaptations of standard form contracts often insert condition precedents that any application be made, with evidence, within a short timeframe.

As we saw in the Cutter v Powell case[33], conditions precedent can create an all-or-nothing situation where you get everything if you perform to the letter, but no reward at all for your efforts if you do not. I have questioned these clauses at the negotiation stage of contracts as potentially unenforceable penalty clauses, although the law has become more relaxed in this area in recent times[34]. The idea that a contractor should forfeit a payment because it does not provide a collateral warranty from a third party by a particular date, for example, does not represent a genuine pre-estimate of the loss that such an omission might cause.

The other problem with these provisions, this time from the employer's side, is that they can lose sight of the reason why extension of time and loss and expense clauses are in the contract to start with. Their purpose is to avoid the contractor treating himself as discharged from the contract because of a change in the nature of the contract which he has been asked to perform. If there is a mechanism within the contract to deal with changes in the time required to do the work, the scope of work and the price, then these changes can be dealt with under the terms of the contract and thus the parties' original bargain remains intact.

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[32] Housing Grants, Construction and Regeneration Act 1996 – see http://www.legislation.gov.uk/ukpga/1996/53/contents

[33] *Cutter v Powell [1795] EWHC KB J13* – see http://www.bailii.org/ew/cases/EWHC/KB/1795/J13.html

[34] Notably in *Obrascon Huarte Lain SA v Her Majesty's Attorney General for Gibraltar [2014] EWHC 1028 (TCC)* In which Akenhead J said a condition precedent should be "construed broadly given its serious effect on what would otherwise be good claims for instance for breach of contract by the Employer" – see http://www.bailii.org/ew/cases/EWCA/Civ/2015/712.html

If the employer can no longer adjust the contract price and the time for completion under the contract, when he has enlarged the scope of the contract or impeded the progress of the works, then the contractor may be able to argue that the employer has repudiated the parties' original bargain, and treat himself as discharged from the contract altogether.

Employers get away with these sorts of contradictory provisions, in my experience, especially on large projects, because contractors are generally reluctant to walk away from a high-profile project. On smaller ones, less in the public eye, however, the contractor may well be willing to walk. I have had one client on a domestic project who tried to amend a standard form contract in such a way as to ensure that the contractor made a loss on the project. This contractor walked, and the client had to pay him some money after an adjudication. Other contractor clients carrying out very visible projects, such as one on Oxford Street in Central London, have rattled their sabres at the employer in similar circumstances, but ultimately, they are unwilling to walk away from such a project.

3.1.3 Are there defects in the work?

Defects, as we all know, are employer-speak for snags in contractor-speak.

A defect or defects presupposes work that has been done. Depending upon the seriousness of the defect, however, the work may have little or no value by comparison with the value assigned to it by the contract if it were defect-free. It may have a negative value if other work has to be undone in order to put it right.

Snags are minor glitches that can be put right relatively easily whilst the contractor continues with other work, or at the end of the job if everything else is finished. Standard form contracts often do not refer to them. The contractor usually asks to be paid for the work as if it were defect-free, with the proviso that he will do any necessary "snagging".

Standard form contracts will provide for a defects liability period and a certificate of making good of defects. But it tends to be only the bespoke contracts which attempt to define what a defect is in general terms. If there is a certifier of some sort under the contract, he or she will tend to treat defective work as unfinished or partially finished work, and value it accordingly.

As we saw earlier, in legal terms, the reduction in the valuation to take account of defective work is an abatement. This did not have to be included in the old withholding notices, but must be specified in sufficient detail in a pay-less notice[35]. If it is not, the defective work may have to be paid for in full, and the payment claimed back in the next valuation as a set-off for breach of contract if the defects have not been remedied by then.

I have been involved in one county court case where the contractor sued our client on an invoice, and we counterclaimed for defective work and brought in the certifier as a third party. The difficulty we had as against the contractor was that we had to prove that the defects were so bad that they rendered the entire work worthless, which we very nearly

[35] Local Democracy, Economic Development and Construction Act 2009, Section 144 – see http://www.legislation.gov.uk/ukpga/2009/20/section/144

succeeded in doing, but the small margin of failure meant that we had to pay our own and some of the contractor's costs. As against the certifier, we established professional negligence because the defects were both serious and obvious on a proper inspection, but the judge rather perversely found that the contractor would have ignored any instructions to remedy the defects, and so the certifier was not liable for more than nominal loss.

Defects in our experience tend to cause many more problems where there is no certifier at all. The contractor invariably regards the defects as snags, and objects to any reduction in his payment to take account of them. The employer regards the contractor as slow and bad at his job, and often loses confidence in him and wants to kick him off site. This scenario repeats itself time and again in domestic projects, which exacerbate the situation because the employer usually wants to live in the completed property, and has all their dreams and often their partner's invested in it. We encourage employers to be pragmatic, and to think carefully about the cost and hassle of throwing the contractor off the job and trying to get someone else to finish it. When acting for the contractor, we have tried where possible to steer the disputes towards mediation, with a surveyor as mediator, and have found that this professional and impartial input usually helps the contractor to make the necessary concessions on his demands for payment to settle the matter.

3.1.4 Has payment for the work been made up the contractual chain?

Domestic projects are exempt from the Construction Act provisions[36], and they again give the most trouble when there is a contractual chain, and the employer at the head of the chain decides to withhold a payment.

One of the feistiest mediations I have undertaken as a mediator involved an American lady employer, supported by an English lady project manager and a very straight-talking property consultant, a Polish main contractor, and an Asian subcontractor. The employer said that the subcontractor had fitted the wrong type of windows in her property, and that she was not going to pay until they were put right. The main contractor did not want to pay the subcontractor until he was paid, but there was some indication that any error in the specification of the windows was down to the main contractor rather than the subcontractor. We found a solution which the parties eventually signed up to two weeks after the mediation meeting, but tempers and personality clashes were very much to the fore in the meeting.

Even on commercial projects, a non-payment up the line will normally result in money being held back down the line as well. The main contractor will usually just value the works at a suitably low figure and put this in a payment notice, to avoid the extra scrutiny attaching to reasons for withholding payment in a pay-less notice. The subcontractor often does not have the resources to challenge interim certificates whilst the job is ongoing.

3.1.5 Was the work supposed to achieve particular objectives or performance specifications?

[36] Housing Grants, Construction and Regeneration Act 1996, Section 106 – see http://www.legislation.gov.uk/ukpga/1996/53/section/106

Section 4 of the Supply of Goods and Services Act 1982 implies a term into business-to-business contracts[37], and Section 10 of the Consumer Rights Act 2015 implies a similar term into business-consumer contracts[38], that where a purchaser makes known, expressly or by implication, any particular purpose for which goods are being acquired, then it is a condition of the contract with a supplier that the goods are reasonably fit for that purpose, whether or not that is a purpose for which such goods are commonly supplied.

Specifications in large construction projects do tend to express a purpose for which goods supplied are being acquired. It may be the very general one of fitting in to the overall construction. It may be a much more specific performance specification that has to be achieved.

One recurring theme I have seen in my practice has been performance specifications for cladding and external door and window frames to limit clattering when the wind blows on the metal. The wind is very unpredictable, and if the work is done in a benign season, it may be difficult to gauge what it might be like in a less benign one. There may also be other nearby buildings that are being demolished and rebuilt, and these can affect the impact of the wind upon the client's building.

Problems like this are very difficult to translate into monetary terms. The work is done, the materials specified are attached to the works, and yet there is a problem. The employer can argue that there is a breach of the specification, and hence a breach of contract claim, but it is not as clear-cut as the missing inches at the bottom of the swimming pool in *Ruxley Electronics & Construction Ltd v Forsyth [1995] UKHL 8*[39] and any compensation for loss of amenity would be hard to calculate and not what a commercial client would want in any case.

There are also cases where the purpose may have been made known to the supplier, but some sort of express qualification is given at the time the contract is entered into. I have encountered this in contracts for Search Engine Optimisation services, which involve the supply of code which makes a website more visible and more interesting to search engines like Google. Clients who purchase the code naturally do so for the purpose of getting more hits on their website which turn into business: all the supplier of the code can achieve, however, is to make the customer's website visible to potential clients who key in particular search terms. When the spending on search engine optimisation exceeds the revenue perceived to be coming from the website, the customer can feel that the "purpose" of the code has not been achieved.

Negotiation or mediation to search for pragmatic solutions is again the best option in these sorts of scenarios.

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[37] Supply of Goods and Services Act 1982, Section 4 – see http://www.legislation.gov.uk/ukpga/1982/29/section/4

[38] Consumer Rights Act 2015, Section 10 – see http://www.legislation.gov.uk/ukpga/2015/15/section/10/enacted

[39] *Ruxley Electronics and Construction ltd v Forsyth [1995] UKHL 8* - see http://www.bailii.org/uk/cases/UKHL/1995/8.html

3.1.6 Is the paying party solvent?

This is a situation I have come across a number of times, especially in the recessions that we have had over the years I have been in business.

Normally, I have been acting for a subcontractor whose main contractor has got into financial difficulties. The detail of the work completed, and its precise value, then becomes somewhat secondary. Everything becomes about whether at least some payment can be secured before the insolvency process takes over.

This is another of those situations where taking formal proceedings can be exceedingly counterproductive. The prospect of an unfavourable judgment in court can be the tipping point which resolves the paying party to start the insolvency process. I have sat with one client in the Bromley County Court all pent up ready to tear strips off the director of the main contractor in cross-examination, only for the judge's clerk to emerge with the bad news that the contractor has written in to say that he has decided to cease trading.

I have also acted on the instructions of a liquidator of my own client when suppliers tried to get paid after an insolvency process kicked in. A liquidator will be able to have any proceedings against an insolvent company stayed pending the completion of the insolvency process, if the proceedings are going to reduce rather than add to the pot of money available to be shared out amongst all the creditors[40]. The supplier kept on making applications to court, but this is one of those situations where you discover that the court is not simply a club with which you can beat an opponent's head, but a process which will stall if the law and the court's rules so dictate.

Probably the most interesting scenario of this kind, however, was a mediation in which I represented a subcontractor who tried to get past the insolvent main contractor to his ultimate employer. Normally, this is impossible because of the legal doctrine of privity of contract, which rules out claims between parties who have no contract between them, even if one party is the ultimate beneficiary of the other party's work. In this case, however, we had evidence that the employer's official who was overseeing the project had arranged through the main contractor for one of our client's sub-contractors to do some work for free to his own home. We threatened a claim in the tort of deceit against the employer, on the basis that he had dishonestly contrived with the main contractor to keep our client out of his money, and were able to negotiate a settlement without the need to issue proceedings.

3.1.7 Is the receiving party solvent?

This situation raises rather different issues, and is particularly important for adjudication, which is an immediately binding but not final remedy.

If an adjudicator gets the facts or the law wrong, his decision is still enforceable, provided that he answered the questions that were referred to him[41].

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[40] Insolvency Act 1986, Section 130(2) - http://www.legislation.gov.uk/ukpga/1986/45/section/130

[41] *Bouygues v Dahl-Jensen [2000] EWCA Civ 507* – see http://www.bailii.org/cgi-bin/format.cgi?doc=/ew/cases/EWCA/Civ/2000/507.html

The remedy for the party who is on the wrong end of the decision is to start all over again in litigation or arbitration.

The question quickly arose: what if the beneficiary of the erroneous decision either is already, or is likely to become, insolvent? Is it fair to enforce the decision against the other party, when they will not have the chance to recover the money in litigation or arbitration? The answer the Court of Appeal gave, applying the relevant Insolvency Rules, was that enforcement would be granted, but stayed pending the outcome of the insolvency process[42].

Earlier on in my career, I acted for a subcontractor in a successful adjudication against their main contractor. As a result of the adjudication going against them, the main contractor became insolvent. As a result of the main contractor becoming insolvent and not honouring the adjudication decision, our client then also became insolvent. We did not get our fees paid, and nor did the adjudicator.

It is fairly easy to appreciate that pursuing a party that might immediately go bust if it loses might not be a good idea. It is a bit less obvious that pursuing another party that owes you money may not be a good idea if you are close to going bust yourself. On the contrary, such a party may feel that they have nothing to lose, and everything to gain.

In more recent times, I acted for a client who was in this last situation. Things were so tight that they almost did not take up the adjudicator's decision. When they did, it was a resounding victory: the decision gave them almost five times what the main contractor had been telling them they should consider themselves lucky to get. Even so, their accountants were not satisfied, and they went into liquidation. Very luckily for them, the contractor paid the sum awarded by the adjudicator: if they had had to apply to enforce the decision as an insolvent company, they might never have seen a penny, as the enforcement would have been stayed.

The best advice in a situation like this may be to leave it to the liquidator to decide whether to pursue the party in default. The liquidator can pursue a large debt if he decides that doing so is likely to add to the amount available to distribute to creditors. Court proceedings or arbitration would then be used in order to obtain a final outcome that could be enforced immediately.

3.1.8 Can other issues be used to set-off or abate?

This is another situation where different dispute resolution processes produce different answers.

We had a contractor come to us who had been brought in to refurbish an old rectory that had been damaged by flooding. The owners' insurers funded these works. The owners then decided that as they had a contractor on site, they might as well get a number of other

[42] *Bouygues v Dahl-Jensen [2000] EWCA Civ 507* – see http://www.bailii.org/cgi-bin/format.cgi?doc=/ew/cases/EWCA/Civ/2000/507.html

works done to the property as well. They entered into a further contract with the contractor to carry out these works.

The contractor carried out the works, but disputes arose about payment and alleged defects. The contractor issued proceedings online against the owners under the second contract (the one not covered by insurance). The owners then counterclaimed under the first contract that was covered by their insurance.

This sort of counterclaim is acceptable in litigation, but it would not be in adjudication or arbitration, which are confined to the contract under which the reference to adjudication or arbitration has been made. Even in litigation, however, it gives rise to complications. In his defence to the counterclaim, the contractor wanted to include a counterclaim of his own for further payment under the second contract which the owners had introduced into the proceedings. This gave rise to confusion and argument, as normally the Claimant has to include the whole of its claim in its Claim Form and Particulars of Claim, and apply to court to amend these if it wants to include something that it did not include at the start[43]. We maintained that our client was equally entitled to defend and counterclaim against any new claim introduced by the owners. The procedural issue was never addressed before the court, as the case went to mediation and settled, but it illustrated the complexities that can arise in litigation, and add to the costs. The reason the other solicitors wanted to make us amend the Claim Form and the Particulars of Claim was that our client would probably have to pay their clients' costs of amending their defence, but would not have to pay for a reply to a defence to counterclaim.

3.2 Breach of contract and negligence

3.2.1 Was this notified in the necessary amount of detail in a payment/pay less notice?

As I observed earlier, one of the aims of the legislation was that unproven breach of contract claims should not too readily be put on a par with claims for stage payments for work completed in accordance with the contract.

The requirements for a valid pay-less notice, as with its predecessor the withholding notice, are therefore quite strict.

The notice has to be delivered to the correct address for notices, within a narrow time window before the final date for payment, and with a detailed breakdown and explanation for the sums that it is proposed will be deducted from the payment applied for[44].

Failure to serve a valid notice does not of course extinguish any valid claims. It simply means that the paying party must "pay now, argue later". The paying party only gets to "argue now" if it can be sufficiently clear about the sums that it proposes to abate from the contractor's stage payment, and the grounds upon which it considers itself entitled to do so.

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[43] Civil Procedure Rules, Rules and Practice Directions, Part 17 - Amendments to Statements of Case – see https://www.justice.gov.uk/courts/procedure-rules/civil/rules/part17

[44] Housing Grants, Construction and Regeneration Act 1996, Section 111 as amended – see http://www.legislation.gov.uk/ukpga/2009/20/section/144

This has led to what have become known as "smash-and-grab" adjudications, where the party faced with claims which have not been recorded in the appropriate form at the appropriate time and sent by the approved means to the appropriate address tries to "grab" the full payment it has applied for without any set-off or abatement.

I successfully carried out one such "grab" for a client not so long ago. The client was a subcontractor whose contract had been terminated, but which at the time of termination had applications for payment outstanding against which no valid pay-less notice had been served. Because we started the adjudication, we were able to avoid any detailed claim against our client arising out of the termination, and collect the sums that the main contractor had failed to challenge at the correct time before termination. Had this claim been issued in court, then the main contractor would have had much more time to set out and quantify his counterclaim.

3.2.2 What happens when work is done, but not by the time it should have been done?

This is a fertile area for disputes, as any delay in carrying out work usually has cost implications both for the party carrying out the work, and the party paying for it.

Industry standard form contracts seek to anticipate disputes of this nature by including provisions for extensions of time and loss and expense claims, or liquidated and ascertained damages for defined periods of delay where they are not excused under the extension of time provisions.

If there are no provisions of this kind in the contract, however, then any delay is potentially a breach of contract. If there is no timescale specified in the contract, then the Supply of Goods and Services Act 1982 will imply a term that the work be done within a reasonable time[45], with what is reasonable being a question of fact. If the contractor takes an unreasonable amount of time, then he will potentially be liable for all the losses that the employer incurs between the end of the time that would have been reasonable, and the actual completion date, subject to legal rules on causation and remoteness of losses.

If the employer is the cause of the delay, then the reasonable time for completion of the works will become longer. The employer may well also be in breach of contract, and liable to compensate the contractor for any extra costs he incurs as a result of the delay. Many of the reasons listed in standard forms as justifying a loss and expense claim by the contractor under the contract, such as acts of prevention, would be breaches of contract where there are no such provisions, and may also be treated as such where there are.

We have acted in these situations both for employers seeking to penalise contractors for being slow, and for contractors seeking loss and expense for being delayed. Both sides frequently blame each other for the delay, and even on the smaller domestic projects, it can be far from easy to disentangle the chain of events and reach some sort of conclusion as to who is right overall. On larger commercial projects, sophisticated methodologies for analysing the critical path in the project programme have been developed, and work by

[45] Supply of Goods and Services Act 1982, Section 14 – see http://www.legislation.gov.uk/ukpga/1982/29/section/14

these experts can be a strong card to play in any set of proceedings, if the logic links are clear and intelligible.

The practical advice that we give to subcontractors in these circumstances is to put in small, well-supported claims early on, as soon as any significant delaying event has occurred. The extension of time and loss and expense claim process operates separately to the regular applications for stage payments, and we often see subcontractors slip up over this, leaving the details of their claim until the next application for payment, when they should be supplying them as soon as they become aware of a delaying event which will have time and cost consequences. Some object that pressing claims too early sours the atmosphere with their contracting partners, but this is what the contract requires very often, and the contracting partners will not be slow to take advantage of this at a later stage. The other advantage of dealing with these claims in small chunks is that there is less incentive for the main contractor to arm himself to the teeth with lawyers and experts if there is a relatively small amount of money at stake. If on the other hand the smaller claims are allowed to snowball into a huge claim at the end of the project, it is likely that the subcontractor will find himself faced with a determined array of consultants seeking to keep him out of the money.

3.2.3 What if there is a breach of contract by the payer of the paying party?

It happens on projects large and small that employers run short of money, and then cannot, or will not, pay their main contractor on time.

This can lead to an awkward situation between the main contractor and his subcontractors.

As we have seen, if the employer actually enters an insolvency process, the main contractor can avoid liability to his subcontractors if he has protected himself in his subcontracts with the sort of "pay-when-paid" clause allowed by Section 113 of the Housing Grants Construction and Regeneration Act 1996[46].

Not all employers who encounter severe cash flow problems actually become insolvent, however, and not all main contractors protect themselves with "pay-when-paid" clauses which comply with Section 113.

This is the type of scenario where a timely suspension of work can force the employer to show his hand, and minimise the resources potentially wasted by the main contractor and the subcontractor.

The employer will often be reluctant to suspend works himself. This is because he may hope that a solution can be found to his cash flow problems, and he does not want to incur liabilities for loss and expense associated with delays in the meantime. If the worst should happen, then he will have the protection of the insolvency regime.

[46] Housing Grants, Construction and Regeneration Act 1996, Section 113 – see http://www.legislation.gov.uk/ukpga/1996/53/section/113

The main contractor and the subcontractor therefore have to judge how far they are prepared to wait before taking the initiative and exercising their own rights to suspend work.

The situation usually arises because the funder or funders of the employer have tightened their purse strings for some reason, or have put conditions on the drawdown of funds which the employer is reluctant to accept. On projects where the chain of contracts has been negotiated from the top down, the funders will usually have obtained collateral warranties from the contractors which allow them to step into their contracts as a new employer in the event of any intervening insolvency or repudiatory breach by the employer under the contract. They will usually want to exercise this right, as they can sell the completed project more easily and recoup their funds. On projects where the contracts have all been individually negotiated between contracting parties without any attempt to make them consistent with other contracts in the chain, which is often the case on smaller projects, then the funders' options may be limited to withdrawing funding and/or winding the employer up, which either way will lead the employer to abandon the project.

I have been involved in a domestic refurbishment project where the employer inherited a house and some funds, and sought to use the funds to refurbish the house for sale. When the funds ran out, the employer did not like the financing terms on offer from the bank, so decided to lay off the contractor. This led to a dispute with the designer and contract administrator, who was accused of letting the contractor do parts of the refurbishment incorrectly. The employer's position was a difficult one, as she was in breach of payment terms to everyone, and the matter eventually resolved itself when the house was sold with the refurbishment only partly completed.

3.2.4 <u>What if the breach is walking away, when insolvent, or for some other reason?</u>

Walking away from a project is a drastic step to take, but it can be both justifiable and prudent in certain circumstances.

It needs careful preparation, however, because it will be a repudiatory breach of contract by the contractor if it cannot be justified.

Larger contractors, working under industry standard or bespoke forms of contract, will usually know the steps that they need to take before they can apply the ultimate sanction.

Smaller contractors working under more rough and ready contracts on domestic projects, however, may up tools and walk as soon as the employer refuses to make a payment that they consider themselves entitled to.

They then turn to the courts to obtain their payment, and find that the employer brings a counterclaim for damages for repudiatory breach of contract.

The preparation required is set out in precise steps under standard form contracts. A default that is specified as such under the contract has to be notified to the employer, and a prescribed period to remedy the default given. If the default is not remedied by the end of the prescribed period, the contract can be terminated.

The alternative, which is available whether the contract has a termination procedure or not, is to accept a repudiatory breach by the employer as bringing to an end the contractor's employment under the contract. This is a common law remedy, which requires evidence that the offending party "evinced an intention not to be bound"[47] by a "fundamental" term of the contract[48]. In practice, it is sensible to observe any notice period specified under the contract, and to identify one of the defaults specified in the contract, as breaches of other terms may not be considered "fundamental".

We find that contractors who walk away without any of these preparatory steps often struggle to prove that an employer has "evinced an intention not to be bound" by a fundamental term of the contract. By far the most common reason for contractors walking off site is payment, and the obligation to make payment is certainly a fundamental term of the contract. But if the non-payment concerned is the difference between what the contractor considers he is entitled to, and what the employer considers he is liable to pay, then the employer has a strong argument that he has not "evinced an intention not to be bound" by the terms of the contract; rather, he and the contractor have a genuine dispute about the contractor's entitlement.

If the contractor fails to prove that the employer is in repudiatory breach, then it is relatively easy for the employer to prove this against the contractor. Carrying out the works is a fundamental term of the contract. Walking off site evinces an intention not to be bound by this fundamental term.

We have seen contractors walk off site because, amongst other reasons, the employer has sworn at them during on site debates about payment and defects, and the employer has tried to enforce an unfavourable payment condition which they carelessly overlooked when negotiating the contract. In one case, the contractor succeeded in justifying his walk-out, and in the other, he did not. In both cases, the overall financial outcome was well below what the contractor was looking for, as credit had to be given for the cost of unfinished works and defects, and each contractor went bust not long afterwards.

Insolvency of the contractor is generally a sufficient reason on its own for an employer to terminate a contract. Contractors also must cease trading if they are unable to meet their own debts as they fall due. Walking away because of financial stress, however, can just exacerbate the problem, and limit the potential for any recovery from the employer because of the substantial counterclaim that a premature termination may give him.

3.2.5 What happens if you sue in the wrong forum or use the wrong process?

We see a number of cases where a claim is brought in arbitration and the defendant claims that it should be brought in court, or vice versa.

Linked to this, there may be a suggestion that the dispute falls under the jurisdiction of somewhere other than England and Wales.

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[47] *Spettabile v Northumberland Shipping Company (1919)* 121 LT 628

[48] The definition of "Fundamental" can be found in *Karsales (Harrow) Ltd v Wallis [1956] EWCA Civ 4*– see http://www.bailii.org/cgi-bin/format.cgi?doc=/ew/cases/EWCA/Civ/1956/4.html

The result is usually that a lot of time and money is spent arguing over the correct process and forum without the substantive dispute being addressed at all.

This is, needless to say, frustrating for a party that is seeking payment.

For an employer, these types of challenges are a useful delaying tactic.

We usually try to move these cases towards negotiated or mediated solutions. There is little point in the parties adding an extra layer to their dispute. There will be more money available to resolve matters in the end if this route is taken.

3.2.6 What about claims of negligence by professionals?

Professional negligence claims are normally covered by professional indemnity insurance, and their defence will usually be conducted by solicitors and barristers appointed by the insurers. They may be brought as a defence and counterclaim in response to a claim for unpaid fees. Professional indemnity insurers should normally be warned of any proceedings commenced against unhappy clients for this reason.

We are not on any insurers' panels, and so we typically find ourselves acting for the Claimant (or Defendant and Counterclaimant) in these situations.

Professionals are frequently drawn into what starts as a dispute between the employer and the contractor. One case I dealt with early in my career involved a contractor who had constructed a staircase without the headroom required by the building regulations; once it was established that he had complied with a specification issued to him by the architect, the claim became one of professional negligence, and it turned out that the drawing in question had been left to a very inexperienced junior architect, and not checked. Another more recent one involved a surveyor who recommended a contractor who he knew had had at least one previous insolvency, who then proceeded to become insolvent again before the job for which he had been recommended had been completed.

We have taken these claims to adjudication, with mixed success. Adjudicators are not always willing to find fellow professionals liable after a 28-day process, particularly if another professional of the same discipline has mounted a robust defence of their position. A good deal of work on the Claimant's expert evidence at an early stage is needed to give the claim a good chance of success by this route.

More usually, we issue a letter of claim under the pre-action protocol for construction and engineering disputes[49]. This is typically focused upon establishing liability, as quantum may require separate expert input to establish, and is unlikely to be discussed seriously whilst liability is denied. In our experience, the insurers managing the case are usually willing to negotiate on a without prejudice basis, either directly between solicitors or in a mediation,

[49] Civil Procedure Rules, Practice Direction – Pre-Action Conduct and Protocols, Pre-action Protocols for Construction and Engineering disputes – see https://www.justice.gov.uk/courts/procedure-rules/civil/protocol/prot_ced

although the negotiations can get very people-heavy, with insurers, barristers, solicitors, experts of various kinds, and the defendants themselves all drawn in.

Contractors often complain about the latitude allowed to professionals, who can only be successfully sued if no ordinary competent member of their profession would have done or failed to do what they did or failed to do[50]. Nevertheless, because professions generally have bodies which regulate their members, there is generally a shared awareness of where the line is to be drawn. Professionals can be more attractive targets for claimants because of their insurance, which effectively ensures a pay-out if the claim succeeds, but their access to significant legal and technical expertise for their defence makes them risky opponents to take on in other ways.

An alternative line of attack upon professionals is to go to their professional regulator or – if the right exists – the ombudsman service which oversees the services that they provide. I have helped clients bring complaints to the ARB, and to the legal and financial services ombudsmen. I have to say that in my experience, it is very hard work to get these bodies to give decisions against insured professionals, and that even when they do, they are often persuaded to change their mind by an appeal, a further representation, or some external advice. The advantage of this route, however, is that there is no risk of an adverse costs order if the claim is rejected: this is a factor which often deters claims at the outset.

3.3 **Fraud**

3.3.1 Should a contractor take money when he knows he is in financial difficulties?

The answer to this from the contractor's point of view is that he must be careful not to continue trading when insolvent, as this will attract various financial, regulatory and possibly criminal sanctions[51].

Making that call is often difficult, however, and professional advice from an accountant may be required.

We do find a number of clients coming to us because a contractor has come to them with financial difficulties that they have not disclosed, and have demanded payment up front for work and materials which were ultimately never supplied because the money went instead to servicing the contractor's existing financial commitments.

We will look at whether the individual director or directors have committed fraud in obtaining the payments first if the contractor has limited liability. This is because claims against the directors under the insolvency legislation will lead, if successful, to money being paid by them to the liquidator for sharing out to all the creditors. Fraud, or some form of negligent misstatement or misrepresentation, provides a way to recover the full amount directly from the contractor's directors.

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[50] Known as the 'Bolam test', *Bolam v Friern Hospital Management Committee [1957], 1 WLR 582*, QBD

[51] If a director of a company continues to trade after the company is insolvent, they may be liable for wrongful trading under the Insolvency Act 1986, Section 214 and asked to contribute to the creditors from their own pockets – see http://www.legislation.gov.uk/ukpga/1986/45/section/214

The trouble is that these claims are very difficult to establish. This is because the contractor is not under a general duty to let employers know about the precise state of his finances, but only not to misstate the position if directly asked. In practice, if the employer had made these enquiries thoroughly and checked out any answers that he received, he probably would not have entered into a contract with the contractor in the first place.

We have seen a number of cases where the contractor is either known socially to the employer, or recommended by a trusted professional as a "sound chap" that they can personally vouch for from years of acquaintance. This of course exacerbates the sense of being let down when money is taken and work and materials are not delivered. There is usually little that can be done in these situations against the contractor, as the employer will be held to have gone in with their eyes open and accepted the risks, but a professional who recommends a contractor to an employer may well be held accountable for that recommendation, albeit in negligence rather than for fraud.

3.3.2 What if the contractor pretends he was dismissed when actually he planned to walk out?

We have acted for an employer in an adjudication brought by his contractor where this was a central issue that the adjudicator had to decide.

One of the employer's nominated subcontractors gave evidence that one of the contractor's managers had told him that they were going to "ditch the job".

The contractor's case was that the employer refused to pay them what they were owed when they gave him an ultimatum to do so, and that they upped tools and left in response to this.

The adjudicator believed the contractor in this case, but if he had not, it could have left the contractor liable for all the additional cost over the contract price that the employer would have had to pay to others to finish the works.

We often hear from employers who complain that their contractor resourced the later stages of their job poorly because they have already moved on to the next big job. This is a less theatrical way of walking out that is much more likely to be planned. Again, the contractor may be exposed to dismissal for not proceeding regularly and diligently with the works, although the legal basis for dismissing him after practical completion when he has been asked to remedy defects is more complex.

Essentially, if there is an element of "cheating" the employer of the work he had bargained for by the contractor, it is best addressed by asserting a repudiatory breach of contract by the contractor rather than by alleging fraud.

3.3.3 What if a sub-contractor buys materials on credit that he was not supposed to buy using his employer's account?

We have dealt with this situation in a county court trial.

The supplier failed to deal with the person authorised to buy on credit under the account, and instead dealt with one of his subcontractors, who proceeded to buy materials to use for other jobs on our client's credit.

The subcontractor had clearly acted fraudulently, but the question was, who should bear the financial consequences of his fraud, when he was absent and of too limited means to be worth suing?

The court held that he had ostensible, if not actual, authority to purchase materials using the account, and that it was for our client, not the supplier, to make sure that he was acting honestly and not abusing that authority for his own gain.

Our client maintained that the subcontractor had introduced him to the supplier, but the supplier maintained that our client had introduced him to the subcontractor. The court preferred the scenario where there was not a conspiracy to commit fraud. We have seen this in other county court trials, such as one where the Claimant alleged that the Defendant had forged an order for some timber: it is often better simply to say that a mistake has been made, as the court will not look for as high a level of proof for such an allegation.