

CONSTRUCTION : BULLETIN

The Payment Trap

For many years, payment in the construction industry has been heavily regulated by the Housing Grants, Construction and Regeneration Act 1996 (the "Construction Act"). However, following the changes to the Construction Act that came into force on 1 October 2011, the consequences for employers of failing to comply with its requirements have become very serious.

Under the majority of construction contracts, once the contractor has made an application for payment, the employer has two opportunities to specify the sum he intends to pay. First of all, the employer may serve a "payment notice". There is a statutory deadline for serving a payment notice which cannot be changed. If the employer misses the payment notice deadline, the sum the contractor applied for usually becomes due automatically.

To avoid having to pay this sum, the employer then has a further limited window of time in which to serve a "pay less notice". If neither the payment notice nor the pay less notice is served, the employer will have no choice but to pay the contractor the sum he applied for, even if the employer disagrees that such amount represents an appropriate valuation of works carried out to date.

Employers can be left with a very hefty bill if they fail to ensure that payment notices and pay less notices are issued on time. This danger is demonstrated by the recent case of *ISG Construction Ltd v Seevic College*. The contractor applied for an interim payment of £1.1m and the employer failed to serve either a payment notice or pay less notice in response. Consequently, the contractor referred the dispute to adjudication and was awarded the full £1.1m, which the employer had to pay even though the employer disagreed that £1.1m was an appropriate valuation of the works carried out to date.

Prior to the ISG case, it was very common for employers who had failed to serve the necessary notices to try to avoid having to pay the full sum applied for by the contractor by launching a counter-adjudication challenging the contractor's valuation of the works. However, the ISG case confirmed that it is not possible for employers to launch such counter-adjudications. This leaves employers who have failed to issue the necessary notices in a position where they have no option but to pay up.

Whilst it is possible to try to recover payment from the contractor by deducting any perceived overpayment from subsequent interim applications, consideration must be given to whether the employer can actually demand that the contractor pays back monies owed. JCT contracts, which are widely used in property development, only cater for payments to be made by the contractor to the employer at the final account stage (i.e. once the defects rectification period has expired). Although the ISG case didn't address this point, the contractor may be able to refuse to repay an overpayment on the basis that the contract does not require him to do so until after expiry of the defects rectification period, potentially leaving the employer out of pocket for months. To avoid such problems, it is best practice going forward to amend the JCT payment terms to allow for interim payments to be made to the employer by the contractor, as well as to the contractor by the employer.

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