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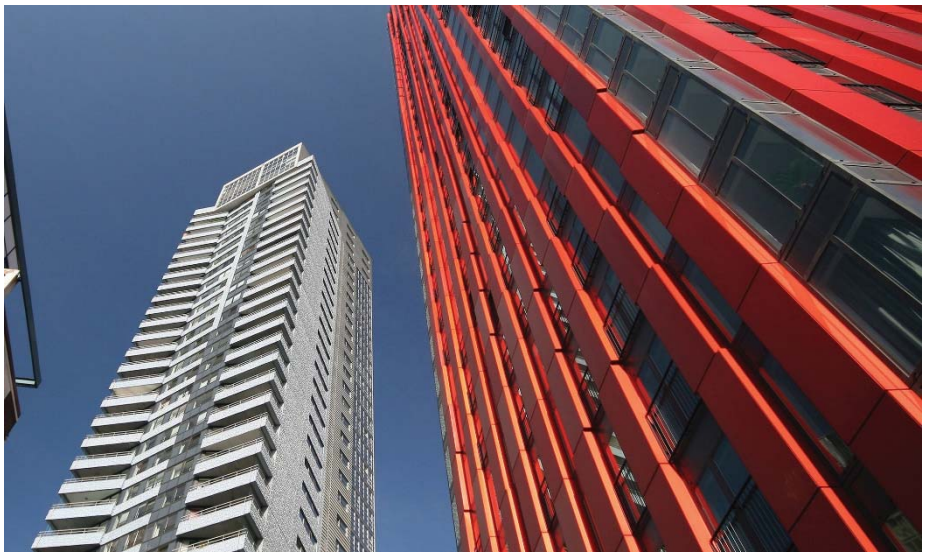
BRIEFING

THE END OF THE LINE? FINAL ACCOUNT PROVISIONS IN CONSTRUCTION CONTRACTS

JANUARY 2018

- ENGLISH HIGH COURT CONFIRMS THAT CASE LAW ON NOTICES ON INTERIM APPLICATIONS ALSO APPLIES TO FINAL ACCOUNT REGIMES
- PARTIAL DISSENT NOT POSSIBLE UNDER THE CONTRACT IN QUESTION



"COULSON J HAS ALSO PROVIDED USEFUL GUIDANCE FOR PARTIES TO CONSTRUCTION CONTRACTS RELATING TO THE INFORMATION AND CALCULATIONS THEY SHOULD INCLUDE IN NOTIFICATIONS RELATING TO PAYMENT DUE."

In *Systems Pipework Ltd v Rotary Building Services Ltd*[1], Coulson J has confirmed that case law concerning notices relating to interim applications should also be applied to final account regimes. In reaching this conclusion, Coulson J has also provided useful guidance for parties to construction contracts relating to the information and calculations they should include in notifications relating to payment due, and the extent to which they are able to partially dissent from payment notifications.

Background

Rotary Building Services Ltd (the "Contractor") employed Systems Pipework Ltd (the "Sub-Contractor") to supply and install steam, condensate, chilled water and cooling water systems at the Davidstow Creamery in Cornwall. The parties entered into a sub-contract relating to these works on 18 December 2014.

The Sub-Contractor carried out the works between December 2014 and May 2016. The parties referred to the portion of the works undertaken up to 31 January 2016 as the "DC1 Works" and the portion after that date as the "DC2 Works", although such distinction was not made in the contract.

The final account regime in the contract was reasonably typical for this type of sub-contract. Pursuant to clause 28.5, the contract required the Sub-Contractor to submit its proposed Final Account to the Contractor.

[1] [2017] EWHC 3235 (TCC)

The Contractor was then required to assess the amount due for payment to the Sub-Contractor based on the proposed Final Account, with clause 28.6 providing:

> "The Contractor shall assess the proper amount due for payment in respect of the Sub-Contractor's Final Account based on the information submitted in accordance with clause 28.5 and shall notify the Sub-Contractor accordingly within 13 weeks of the Sub-Contractor's proposed Final Account or such longer time as would be reasonable in all the circumstances taking account of the Main Contract conditions.
>
> In the absence of a proposed Final Account submission from the Sub-Contractor in accordance with clause 28.5, the Contractor may value the proper amount due for payment submission of the Sub-Contractor's Final Account on a fair and reasonable basis and notify the Sub-Contractor accordingly.
>
> In either case, if such notification is not dissented from in writing by the Sub-Contractor within 14 days, then the notified figure will be deemed to have been agreed and will be binding on the parties."

The relevant timeline was as follows:

- 17 May 2016 – The Sub-Contractor emailed the Contractor a "revised final account for DC1" asking for "review and comment".
- 22 May 2016 – The Sub-Contractor made an interim application in respect of the DC2 Works.
- 2 September 2016 – The Contractor provided a document to the Sub-Contractor described in the covering letter as "our final account assessment for the works" (the "Final Account Assessment"). This set out a comparison of the Sub-Contractor's and the Contractor's valuation of all the works (both DC1 and DC2), but did not set out the payment which the Contractor assessed as due to the Sub-Contractor based on its valuation. On the Contractor's case, this nevertheless sufficed for the requisite clause 28.6 notification and so, given that the Sub-Contractor did not dissent in respect of the Works within the required 14 days, the notified figure was deemed to have been agreed.
- 16 September 2016 – The Sub-Contractor commenced adjudication in respect of its entitlement to payment for the DC2 Works (the "First Adjudication"). It was held that the Contractor was liable to the Sub-Contractor in the amount of just under £250,000 for the DC2 Works.
- 20 September 2016 – The Contractor commenced adjudication seeking a declaration that the Sub-Contractor was bound by the Final Account Assessment (the "Second Adjudication"). The adjudicator decided that the Sub-Contractor was not bound by the Final Account Assessment to the extent that it dealt with the DC2 Works because it had dissented to that part of the Final Account Assessment in accordance with clause 28.6 by commencing the First Adjudication. However, it was held that the Sub-Contractor was bound by the remainder of the Final Account Assessment.

The Sub-Contractor brought CPR Part 8 proceedings before the Technology and Construction Court, seeking to challenge the adjudicator's decision in the Second Adjudication.

Issues

There were three key issues between the parties:

1. As a matter of construction of the contract, what notification was the Contractor obliged to give the Sub-Contractor in order for that notification to be binding under the final sentence of clause 28.6?
2. Was the Final Account Assessment the required notification under clause 28.6?
3. If the Final Account Assessment was the required notification in accordance with the contract, was it validly dissented from?

Decision

Issue 1

In addressing this issue, Coulson J considered case law dealing with notices under payment application regimes. Most such cases relate to interim application disputes, and there are a surprising lack of decisions concerning final account regimes. However, Coulson J had no hesitation in deciding that that line of case law relating to interim applications applies equally, if not more strictly, to final account regimes and, in this case, to clause 28.6 and the Contractor's Final Account Assessment.

"THERE ARE A SURPRISING LACK OF DECISIONS CONCERNING FINAL ACCOUNT REGIMES."

By reference to the last sentence of clause 28.6, Coulson J focussed on the Contractor's right to assess "the proper amount due for payment in respect of the Sub-Contractor's Final Account". He interpreted this to require a notification of the amount due for payment and by reference to the terms of clause 28 as a whole, highlighted the distinction drawn in the contract between a gross valuation on the one hand and an assessment of the sum due and payable on the other; the latter being calculated by the deduction of sums previously paid and retention from the gross valuation.

Thus it was held that the notification under clause 28.6 had to consist of two parts:

a) an assessment/valuation of the total value of the Works; and
b) a calculation of the sum due and payable taking into account previous payments and any ongoing retention. The Contractor had to notify the amount it assessed as due and payable and could not simply provide a final account valuation which could be used to calculate the sum payable.

Issue 2

Coulson J concluded that on the basis of the requirements of clause 28.6, the Final Account Assessment was plainly not a proper notification of the amount due for payment because:

1. Neither the Final Account Assessment nor the covering letter identified themselves as a notification of an amount due, instead being described as Final Account assessments.
2. Neither the Final Account Assessment nor the covering letter identified a particular sum that was payable by the Contractor. Rather it was an assessment of the value of the Works completed. As such, it was only the first half of the calculations required to be notified under clause 28.6.
3. There was no reference in the Final Account Assessment or the covering letter to clause 28.6 and there was no indication in those documents that it was a notification under that clause. Importantly, Coulson J expressed the view that "if a

notice under a certain clause has a draconian effect pursuant to the contract, the notice should make clear that it has been issued under that clause".

4. In this case, on the Contractor's own evidence, the Final Account Assessment and covering letter were not the notification of "an amount due".
5. It should be noted that Coulson J considered that the fact that the Sub-Contractor might have been able to work out or otherwise calculate what the sum might be was nothing to the point, as the calculation was the very thing that clause 28.6 sought to obviate.

Coulson J helpfully emphasised that:

> "…if X is supposed to be notifying Y that a sum is due, under a clause that provides for a deemed agreement that binds the parties unequivocally, then it is a prerequisite of the arrangement that the sum due and the clause are clearly set out in the relevant notice. It is not good enough to say that the recipient could have worked it out for themselves…".

Issue 3

Following Coulson J's conclusion on Issues 1 and 2, consideration of Issue 3 was not strictly necessary. However, in case he was wrong on those points and there was proper notification, he concluded that the Sub-Contractor had in any event validly dissented under clause 28.6. In reaching this conclusion the judge provided some useful guidance in respect of partial dissent.

"COULSON J REJECTED THE SUGGESTION THAT … PARTIAL DISSENT WAS POSSIBLE."

In the Second Adjudication, the Adjudicator had decided that by commencing the First Adjudication only in relation to the DC2 Works, the Sub-Contractor had only dissented to that part of the Final Account Assessment. Coulson J rejected the suggestion that such partial dissent was possible:

> "The third reason concerns the [Contractor's] submission that a partial dissent, and therefore a partial agreement, was possible. … But there is nothing in clause 28.6 which suggested that this process was capable of being triggered only in part and that notification and/or dissent and/or the deemed agreement and/or the binding nature of that agreement were somehow capable of being infinitely divisible. It is, as [counsel for the Sub-Contractor] correctly put it, a binary question. Anything else would have been difficult, if not impossible, to operate and would run counter to the alleged clarity brought by this provision".

Coulson J went on to indicate that he further agreed with the Sub-Contractor that if there had been separate notifications by the Contractor relating to the DC1 and DC2 Works and the dissent had related to one notice only then the position might have been different. However, that was not the case here.

Conclusion

Coulson J's decision that the prevailing principles which have been applied to interim application regimes also apply to final account regimes will provide some welcome reassurance and certainty to the construction industry.

There are also two more key practical points to be taken from Coulson J's judgment which employers and contractors should be aware of:

- Employers should be careful not to simply submit a valuation of the works completed when the contract requires notification of the payment sum due to the contractor. Employers often prefer not to calculate and give notice of the exact payment due to the contractor for fear of waiving any further claims they may have. However, as demonstrated by this case, failing to express the precise amount the employer calculates is due risks losing the right to rely on that valuation, or the contractor's acceptance of the same, at a later date. In addition, where a party intends to give notice under a specific clause, it should ensure that it expressly refers to that clause in the notice. This principle is all the more important where a notice under that clause has a "*draconian effect*".
- Parties should be aware that unless expressly provided for in the contract, it is unlikely that they will be able to partially dissent to notices issued under the contract particularly where there are distinct phases to works. As such, when issuing draft final accounts or other notices under payment regimes, parties should consider whether it would be appropriate to issue more than one separate notice so that the relevant counterparty has the ability to agree to the figures contained in one notice whilst dissenting to others. Although Coulson J's decision does not guarantee that parties in this situation would be able to dissent from one notice whilst agreeing to another, he does suggest that it might be more likely that they are able to do so.

The Housing Grants (Construction and Regeneration) Act 1996 introduced reforms intended to address a problem in the construction industry whereby employers and main contractors failed to answer claims for payment by sub-contractors. One of the effects of the Act was that paying parties are required to identify relatively quickly what they say is due and why. In reaching his decision in this case, Coulson J was well aware of the recent concern that this reform has gone too far, such that draconian provisions in construction contracts setting strict time limits for dissenting from notices of payments due are depriving parties of their permanent rights and obligations.

"NOTICES … SHOULD BE CLEAR AND UNAMBIGUOUS AND … A HIGH THRESHOLD IN TERMS OF CLARITY WILL HAVE TO BE MET BY PARTIES WHO WISH TO RELY ON THEM."

Coulson J's decision is significant in that whilst on the one hand he confirms that prevailing principles which apply to interim application regimes will also apply to final account regimes, on the other hand he seeks to temper the effect of such provisions by emphasising that notices under them should be clear and unambiguous and that a high threshold in terms of clarity will have to be met by parties who wish to rely on them. This notion is echoed by our Briefing on *'Payment Regime in JCT Contracts'* in October 2015 which highlighted that the safest course is to adhere strictly to the contractual payment regime and make this clear from the start to avoid uncertainty and any waiver arguments.

FOR MORE INFORMATION

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