

# Insight

*Insight* provides practical information on topical issues affecting the building, engineering and energy sectors.

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Pay Less Notices: What about their contents?



## Pay Less Notices: What about their contents?

The Housing Grants, Construction and Regeneration Act 1996 (as amended) (the “Act”) includes multiple provisions to encourage timely payments throughout the construction supply chain. Of those, Pay Less Notices are perhaps one of the most notorious not least because serving them on time is often crucial.

That said, disputes as to the contents of Pay Less Notices (and whether they are therefore compliant) seem to be on the rise, with some of the arguments raised becoming more far-fetched as cash flow becomes ever more critical. In this *Insight* we therefore review the key case law on the contents of Pay Less Notices and ask what practical lessons can be learnt from that case law in order to avoid having to face such arguments in the first place.

### The Act and Pay Less Notices

Section 111(1) of the Act provides that the paying party must make payment of the “notified sum” on or before the final date for payment. The “notified sum” is the sum specified in the paying party’s payment notice or, if no such notice was issued, the payee’s default payment notice.

Should the paying party wish to pay less than the “notified sum” they must serve a compliant pay less notice.<sup>1</sup> By section 111(4), a pay less notice issued under section 111(3) must specify:<sup>2</sup>

(a) the sum that the paying party considers to be due as at the date of the pay less notice. This sum may be zero; and

(b) the basis on which that sum is calculated (a “Pay Less Notice”).

However, the Act says nothing further in respect of the precise information which should be included in a Pay Less Notice.

### So what does the case law say on the content of Pay Less Notices?

The TCC’s approach to the construction of Pay Less Notices was outlined in detail in *Grove Developments Ltd v S&T (UK) Ltd*<sup>3</sup> and subsequently approved by the Court of Appeal.<sup>4</sup>

One of the issues before the court was whether Grove’s Pay Less Notice complied with the contractual requirement that payment notices “specify the basis of calculation” of the sum stated to be due.

It was common ground between the parties that Grove’s payment notice was invalid, as it had been issued out of time. Grove therefore relied upon its Pay Less Notice, which was issued in time. On its face the Pay Less Notice was defective, because it did not set out the basis on which the sum considered to be due had been calculated. The Pay Less Notice did, however, refer back to a detailed calculation in a spreadsheet sent by Grove previously with its (invalid) Payment Notice.

S&T argued that the Pay Less Notice was invalid because it did not expressly set out the basis of the calculation of the sum considered to be due. It was not sufficient, S&T claimed, for the Pay Less Notice to refer back to the detailed calculation set out in the spreadsheet attached to Grove’s Payment Notice.

Upon considering the relevant case law authorities, Coulson J held that the detailed calculation sent with Grove’s payment notice “would have permitted the reasonable recipient to understand precisely” how the employer’s valuation was calculated.<sup>5</sup> He also stated that “there can be no possible objection in principle to a notice referring to a detailed calculation set out in another, clearly-identified document”.<sup>6</sup> Grove’s Pay Less Notice was therefore valid.

In reaching his decision, Coulson J considered the relevant principles on the construction of Pay Less (and other) Notices. In doing so he identified three key tests and/or rules for their interpretation as follows:

1. How would a “reasonable recipient” have understood the notice?

2. It is inappropriate to apply a “fine contextual analysis” to the contents of Pay Less Notices (or indeed other notices) and “artificial and contrived” arguments are not allowed.

3. Does the notice provide an “adequate agenda for adjudication”?

These are examined in turn below.

### 1. How would a “reasonable recipient” have understood the notice?

In referring to the House of Lords’ judgment in *Mannai Investments Co Limited v Eagle Star Life Insurance Co*<sup>7</sup>, Coulson J confirmed that the construction of Payment and Pay Less Notices:

“... must be approached objectively, because **the issue is how a reasonable recipient would have understood the notice.** In addition, when construing the notice, the court must take into account the relevant ‘objective contextual scene’.”<sup>8</sup> [Emphasis added]

He observed that the approach in *Mannai* had been expressly adopted by the TCC when considering the validity of Pay Less Notices, including in the case of *Jawaby Property Investment Limited v The Interiors Group Limited*.<sup>9</sup>

In *Jawaby*, the employer relied upon its mark-up of the contractor’s initial application for payment as a valid Pay Less Notice. On considering the validity of that purported Pay Less Notice, the

court held that it was not a Pay Less Notice because “it was not intended to be” such a notice.

The intention of the sender is therefore an important factor to be assessed when considering the validity of a notice:

“... it is, as set out above, an **essential requirement for the service of a contractual notice that the sender has the requisite intention to serve it.** The senders’ intention is a matter to be assessed objectively taking into account the context.”<sup>10</sup>

**2. It is inappropriate to apply a “fine textual analysis” to the contents of pay less notices and “artificial and contrived” arguments as to their form are not allowed.**

A court will take a practical, common sense view when assessing the contents of Pay Less Notices. In particular, it will not allow “artificial or contrived arguments” as to the form of such notices.

Indeed, as stated by Coulson J in his book on Construction Adjudication:

“**The courts will take a common sense, practical view of the contents of a payless notice and will not adopt an unnecessarily restrictive interpretation of such a notice ... It is thought that, provided that the notice makes tolerably clear what is being held and why, the court will not strive to intervene or endeavour to find reasons that would render such a notice invalid or ineffective.**”<sup>11</sup> [Emphasis added]

This approach was confirmed in the TCC cases of *Thomas Vale Construction plc v Brookside Syston Ltd*<sup>12</sup> and *Windglass Windows Limited v Capital Skyline Construction Limited*,<sup>13</sup> to which Coulson J also referred in *Grove*.

In *Thomas Vale*, HHJ Kirkham observed that it is “inappropriate” to apply a “fine textual analysis” to a notice that “is intended simply to communicate why a certain payment was not to be made”.<sup>14</sup> In a similar

vein, Coulson J himself stated in *Windglass* that:

“**the courts will take a practical view of the contents of a withholding notice and will not allow complaints as to form which might be described as artificial and contrived**”<sup>15</sup>. [Emphasis added]

This is obviously helpful for those facing arguments that a Pay Less Notice is invalid when a common-sense approach would dictate otherwise.

**3. Does the notice provide an “adequate agenda for adjudication” as to the value of the works and the alleged entitlement to payment?**

Coulson J also referred to *Henia Investments Limited v Beck Interiors Limited*.<sup>16</sup> In that case Akenhead J indicated that one way of testing the validity or otherwise of a Pay Less Notice is to see whether it provides “an adequate agenda for an adjudication as to the true value of the works and the validity of the alleged entitlement” to payment.<sup>17</sup>

This was repeated by Alexander Nissen QC in *Surrey and Sussex Healthcare NHS Trust v Logan Construction (Southeast) Limited*,<sup>18</sup> in which the issue was whether an email and its attachments were sufficient to amount to a Pay Less Notice. The court held that the email and attachments did provide an adequate agenda for adjudication, as they provided all the information Logan needed to know in respect of the disputed account. There was nothing more it needed to know.

Helpfully, having referred to the above authorities Coulson J then tied all three themes together and summarised them as follows:

“A pay less notice will be construed by reference to its background, in order to see how a **reasonable recipient** would have understood it. The court will be **unimpressed by nice points of textual analysis, or arguments which seek to condemn the notice on an artificial or contrived basis.** One way of testing to see whether the

contents of the notice are adequate is to see if the notice provides an **adequate agenda** for a dispute about valuation and/or any cross-claims available to the employer.”<sup>19</sup> [Emphasis added]

Coulson J’s decision at first instance was subsequently upheld by the Court of Appeal in *S&T (UK) Ltd v Grove Developments Ltd*.<sup>20</sup> Sir Rupert Jackson referred to the cross-reference (in the Pay Less Notice) to the detailed calculation issued previously, and stated that it:

“... did not, and could not, give rise to any doubt or misunderstanding in the mind of a reasonable recipient standing in the shoes of S&T”.<sup>21</sup>

**So what are the limits of the “reasonable recipient” test?**

As set out above, making your intention clear (i.e. you did intend your email to be a Pay Less Notice) is always going to assist you in retrospect when you are seeking to rely on it. So what are the limits of the “reasonable recipient” test?

Well in the case of *Surrey and Sussex Healthcare NHS Trust v Logan Construction (Southeast) Limited*,<sup>22</sup> the court held that a Pay Less Notice did not need to be entitled “pay less notice” on its face nor did it need to refer to the relevant specific contract clause in order to be valid.

However, this is perhaps to be treated with caution. *Systems Pipework Limited v Rotary Building Services Limited*<sup>23</sup> also considered similar issues albeit in the context of a notice for the assessment of a final account rather than a Pay Less Notice.

Coulson J found that:

(a) A reasonable recipient would not have regarded the documents as notification of the sum due as there was no reference to the relevant contract clause, nor was the actual sum due referred to; and

(b) The fact that the recipient might have been able to work out the sum due and the relevant clause was “not good enough”.<sup>24</sup>

In other words, Coulson J held that a party should set out the sum due and refer to the relevant clause of the contract. This seems to conflict with *Surrey and Sussex Healthcare* particularly in relation to the need to refer to a specific contract clause in the notice. That said, it is to be noted that the *Systems Pipework* decision was made in the context of the final account and an argument as to whether the recipient of the notice had lost their right to contest the valuation reached once and for all.

Nevertheless, if a notice is obviously labelled with the relevant contract clause it is served under and identifies what it is (i.e. it is clearly labelled “Pay Less Notice”) then there is clearly less room for doubt as to the notice’s purpose.

**Practical pointers**

In practice then the following information should be included in any Pay Less Notice in order to avoid any arguments as to its validity in relation to its contents (albeit you also need to serve it on time and correctly):

1. Label your document “**Pay Less Notice**” and refer to the relevant clause of the contract and/or section of the Act under which it is being issued;
2. Refer to the “*notified sum*” as notified either in the Payment Notice previously issued to the payee or, if no Payment Notice was issued, in the payee’s application for payment or Default Payment Notice;
3. Set out your reason(s) for paying less than the notified sum;<sup>25</sup>
4. Provide a mathematical calculation showing how the notified sum is being revised downwards. In other words, set out how the sum considered to be due is calculated. Do your sums add up?

5. Avoid referring to other documents that aren’t attached or very clearly identified if possible. Whilst *S&T v Grove* confirms that a Pay Less Notice can refer to a detailed calculation set out in another clearly identified document issued to the payee previously this can leave room for arguments. Is it clear to an outsider (i.e. an adjudicator) what you are referring to, especially with the passage of time? If you have no choice then make sure there is no room for doubt as to what version of the document you are referring to and, once again, make your sums in your summary page add up to the same as those in that document?
6. Set out the sum that will now be paid (that is, the sum that is now considered to be due to the payee) as a result of that reason and calculation. For the avoidance of any doubt, if the mathematical calculation shows that a negative sum (e.g. –£10,000) is due, you may well want to state that no payment is due to the payee (i.e. that £0 is due). Whilst you would hope that any argument that a negative sum being stated as due was somehow non-compliant would be dismissed out of hand, why allow that argument to be raised when you can avoid it?

In the current market, we are seeing increasingly far-fetched arguments regarding Pay Less Notices being raised at all levels of the supply chain as cash flow becomes more and more important. Accordingly, adhering to best practice to avoid facing such arguments is more important than ever.

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July 2020**

Footnotes

1. See section 111(3) of the Act.
2. By section 111(5), a pay less notice must also be issued no later than the prescribed period before the final date for payment, and which the parties to the contract are free to agree.
3. [2018] EWHC 123 (TCC).

4. [2018] EWHC 123 (TCC) as subsequently approved by the Court of Appeal in *S&T (UK) Ltd v Grove Developments Ltd* [2018] EWCA Civ 2448.
5. *Grove Developments Ltd v S&T (UK) Ltd* [2018] EWHC 123 (TCC) at 33.
6. *Grove Developments Ltd v S&T (UK) Ltd* [2018] EWHC 123 (TCC) at 34.
7. *Limited* [1997] 1 AC 749.
8. *Grove Developments Ltd v S&T (UK) Ltd* [2018] EWHC 123 (TCC) at 21.
9. [2016] EWHC 557 (TCC).
10. *Jawaby Property Investment Limited v The Interiors Group Limited* [2016] EWHC 557 (TCC) at 63.
11. *Coulson on Construction Adjudication*, 2018, 4th edn, paragraph 3.36.
12. [2006] EWHC 3637.
13. *and Anr* [2009] EWHC 2022 (TCC).
14. *Thomas Vale Construction plc v Brookside Syston Ltd* [2006] EWHC 3637 at 43.
15. *Windglass Windows Limited v Capital Skyline Construction Limited and Anr* [2009] EWHC 2022 (TCC) at 14(c).
16. [2015] EWHC 2433 (TCC).
17. *Henia Investments Limited v Beck Interiors Limited* [2015] EWHC 2433 (TCC) at 32.
18. *Surrey and Sussex Healthcare NHS Trust v Logan Construction (Southeast) Limited* [2017] EWHC 17 (TCC) at 61.
19. *Grove Developments Ltd v S&T (UK) Ltd* [2018] EWHC 123 (TCC) at 26.
20. [2018] EWCA Civ 2448.
21. *S&T (UK) Ltd v Grove Developments Ltd* [2018] EWCA Civ 2448 at 55.
22. *Surrey and Sussex Healthcare NHS Trust v Logan Construction (Southeast) Limited* [2017] EWHC 17 (TCC).
23. [2017] EWHC 3235 (TCC).
24. *Systems Pipework Limited v Rotary Building Services Limited* [2017] EWHC 3235 (TCC) at 35.
25. In contrast to a withholding notice under the old payment regime (prior to the amendments to the Act introduced by the Local Democracy, Economic Development and Construction Act 2009), a pay less notice does not need to include the grounds for paying less, and so the reason for paying less than the “notified sum” is included for completeness. For the avoidance of doubt, however (and as stated above), a pay less notice must always specify the basis on which the sum considered to be due has been calculated.