<u>The JCT Contract in a Cold Climate</u>

Introduction

1. In these harsh times, a number of difficult situations may arise. This talk considers two of them by reference to the SBC/Q form and recent case law:

   (1) The Employer fails to pay sums properly due to the Contractor;

   (2) The Contractor becomes insolvent.

2. Of course, in either situation the innocent party may wish to continue with the Contract. But more likely is the scenario where this party wishes to determine, and cut its losses.

Employer fails to pay

3. Clause 8.9 of SBC/Q provides so far as relevant:

> *"8.9.1 If the Employer:*
>
> *.1 does not pay by the final date for payment the amount properly due to the Contractor in respect of any certificate and/or any VAT properly chargeable on that amount; or*
>
> *…*
>
> *the Contractor may give to the Employer a notice specifying the default or defaults (the 'specified default or defaults').*
>
> *…*
>
> *.3 If a specified default or a specified suspension event continues for 14 days from the receipt of notice under clause 8.9.1 or 8.9.2, the Contractor may on, or within 10 days from, the expiry of that 14 day period by a further notice to the Employer terminate the Contractor's employment under this Contract.*

.4 If the Contractor for any reason does not give the further notice referred to in clause 8.9.3, but (whether previously repeated or not):

.1 the Employer repeats a specified default;

...

then, upon or within a reasonable time after such repetition, the Contractor may by notice to the Employer terminate the Contractor's employment under this Contract."

4. So the scheme (which has been in the JCT contracts for long time) is:

   (1) Failure to pay by the final date for payment;

   (2) Notice of default;

   (3) If default continues for 14 days, the Contractor has 10 days in which to give notice to terminate;

   (4) If default repeated, then, within a reasonable time, the Contractor may terminate the Contract.

5. Note (Clause 8.2.1) that notice of termination *"shall not be given unreasonably or vexatiously..."*

6. In Reinwood Ltd v L Brown & Sons Ltd these provisions (albeit in the 1998 form) came under scrutiny.

7. The facts were:

14.12.05	Architect issued Certificate of Non-Completion.
11.1.06	Architect issued Interim Certificate showing £187,988 due.
17.1.06	Employer:
	(1) Issued Clause 24.2 Notice of Intention to deduct LADs from 14.12.05.
	(2) Gave notice under clause 30.1.1.3 of intention to pay only £126,359 i.e. a deduction of £61,629 for LADs.
20.1.06	£126,359 paid.
23.1.06	EOT granted to 10.1.06
25.1.06	Final date for payment
26.1.06	Notice of default given, on basis that due to EOT Employer only entitled to deduct £12,326 for LADs.
28.6.06	Final date for payment of £39,981 under further Interim Certificate.

5.7.06 Notice of termination given.

6.7.06 £39,981 paid.

8. At first instance ([2007] BLR 10), HHJ Gilliland upheld the validity of the termination. In a robust Judgment, it was held that:

(1) The January notice was valid;

(2) The July 2006 notice was given at the appropriate time;

(3) The Contractor had not acted unreasonably or vexatiously.

9. Two aspects of this robust Judgment calls for comment.

10. The first was the Judge's analysis of Clause 28.2.4 of the Contract before him (now 8.9.4):

> *"34. ... It is in my judgment impossible to imply into clause 28.2.4 a term that a reasonable time must elapse between the repetition of the specified default and the giving of the notice of determination. Such a term would be inconsistent with the express terms of clause 28.2.4 which provides that a notice of determination may be given "upon or within a reasonable time after such repetition". If a notice may be given "upon or within a reasonable time after" the repetition of the specified default, it cannot be implied that it may only be given after a reasonable time. Such an interpretation or implication would involve disregarding the words "upon or" in clause 28.2.4. Clause 28.2.4 is in my judgment clear and unambiguous and it provides that a notice of determination may be given as soon as the specified default has been repeated. There is nothing unreasonable in that, since the employer has already received a warning in respect of the previous default and must be taken to know that if he repeats the default he runs the risk that the contract may be determined either forthwith or within a reasonable time after the repetition of the specified default. The inclusion of the words "within a reasonable time" in clause 28.2.4 make clear that if the contractor is to terminate the contract because a specified default has been repeated, the contractor must act reasonably*

promptly. He may not, for example, either delay unreasonably in giving a notice of determination or allow the contract to proceed and then at some later date of his choosing seek to determine the contract for that breach. The words limit the period within which any notice must be given. They do not postpone or delay the period within which a notice may be given or give the employer a period of grace before contract may be determined."

11. The second was his distillation of the case law on the phrase *"unreasonably or vexatiously"*:

> *"39. In my judgment the following propositions may be derived from these authorities:*
>
> *1. It is for the employer to show on the balance of probabilities that the contractor has determined the contract unreasonably or vexatiously.*
>
> *2. By vexatiously is meant that the contractor determined the contract with the ulterior motive or purpose of oppressing, harassing or annoying the employer.*
>
> *3. The test of what is an unreasonable determination is to be ascertained by reference how a reasonable contractor would have acted in all the circumstances.*
>
> *4. It is not for the court to substitute its own view of what is reasonable for the view taken by the contractor if that is one which a reasonable contractor might have taken in the circumstances.*
>
> *5. Although the motive or purpose which a contractor had in exercising the right of determination is a relevant consideration, the test of what is unreasonable conduct in this context is objective and the fact that the individual contractor may have thought that his conduct in determining the contract was reasonable is not conclusive.*
>
> *6. The effect on the employer of determination by the contractor is a factor to be taken into account and a determination may be unreasonable if it disproportionately disadvantages the employer.*
>
> *40. In giving a notice of determination under clause 28.2.4, the contractor in my judgment is entitled to have regard to his own commercial interests. It should be remembered that under clause 28.2.4 a notice of determination may only be served if the employer has either repeated a breach of contract about which he has previously received a warning*

under clause 28.2.1 or, where the notice of determination has been given under clause 28.2.3, continued the breach for 14 days after being warned of the breach. It is clear from clause 28.2.1 that a failure on the part of an employer promptly to pay the amount properly due under a certificate (or the VAT on that amount) is regarded under the contract as a serious breach on the part of the employer and that the contractor may determine the contract if the breach is repeated provided only that the contractor is not acting vexatiously or unreasonably. The contractor is entitled to be paid by the due date and he is not, for example, bound to incur the expense of pursuing other remedies such as adjudication or arbitration in order to obtain payment but may determine the contract. It is also to be noted that the contractor is by the terms of clause 28.2.4 entitled to give notice of determination "upon" or within a reasonable time of the repetition of the specified default and accordingly it cannot be said the contractor must wait to find out why he has not been paid before determining the contract. The clause contemplates that there may be cases where a reasonable contractor may determine the contract forthwith upon a failure to pay monies which are due under a certificate."

12. Unfortunately for the Contractor, the Court of Appeal ([2007] BLR 305) and the House of Lords ([2008] BLR 218) subsequently held that the notice of 26.1.06 was invalid.

13. The reasoning of their Lordships was as follows, as summarised by the learned editors of the BLR:

> *"(1) Provided the two preconditions in clause 24.2.1 are satisfied, namely that the architect has issued a Certificate of Non-Completion under clause 24.1 and the employer has informed the contractor in writing before the date of the Final Certificate that he intends to withhold or deduct LADs, then clause 24.2.1.1 entitles the employer to give a notice under clause 30.1.1.4 stating that he intends to deduct LADs from monies due to the contractor.*
>
> *(2) Once that notice under clause 30.1.1.4 has been issued, then, absent special circumstances, both contractor and employer should be entitled to proceed on the basis that payment will and can properly be made in accordance with that notice.*
>
> *(3) The issue of the extension of time by the Architect in January 2006, prior to the Final Date for payment of interim certificate no. 29, did not deprive the employer of the right that he had (by satisfying the two preconditions in clause 24.2.1, serving the withholding notice, and*

paying the relevant sum) to pay the amount calculated by reference to the withholding notice.

(4) Although the extension of time granted by the architect in January 2006 had the effect of cancelling the Certificate of Non-Completion issued in December 2005, such cancellation did not have retrospective effect.

(5) By cancelling the Certificate of Non-Completion, the contractor acquired the right under clause 24.2.2 to be paid the amount that had been deducted. No date for that payment is included in that clause. Section 110(1) of the Housing Grants, Construction and Regeneration Act 1996 therefore applied and the Scheme provided a mechanism for calculating that date. After application for the sum by the con tractor, the sum would become due after seven days, and the final date for payment would be 17 days thereafter."

14. So the Contractor was hamstrung in his attempt to determine by the fact that, as analysed by their Lordships, there had been no failure to pay in January 2006.

15. Undaunted, the Contractor unearthed an earlier non-payment in May 2005 (more than a year prior to the eventual termination in July 2006).

16. The Judge, on this occasion upheld by the Court Appeal [2009] BLR 37, held that this earlier non-payment could be the foundation for the termination since:

(1) The Contractor was entitled to rely, as at July 2006, upon facts then in existence (i.e. the May 2005 non-payment) even though in fact he had relied upon the January 2006 issues;

(2) The lapse of time did not amount to a waiver of rights.

Insolvent Contractor

17. By Clause 8.5.1 of the SBC/Q, the Employer has an absolute right (subject only Clause 8.2.1) to terminate the Contractor's employment *"If the Contractor is insolvent…"*

18. If this happens, Clause 8.7 and 8.8 come into effect. For the purpose of this lecture, I am particularly concerned with provisions for payment.

19. These are as follows:

> *".3 (if not already applicable) clauses 8.7.4, 8.7.5 and 8.8 shall thereupon apply and the other provisions of this Contract which require any further payment or any release of Retention to the Contractor shall cease to apply;*
>
> *.4 within a reasonable time after the completion of the Works and the making good of defects (or of instructions otherwise, as referred to in clause 2.38), an account of the following shall be set out in a certificate issued by the Architect/Contract Administrator or a statement prepared by the Employer:*
>
> > *.1 the amount of expenses properly incurred by the Employer, including those incurred pursuant to clause 8.7.1 and, where applicable, clause 8.5.3.3, and of any direct loss and/or damage caused to the Employer and for which the Contractor is liable, whether arising as a result of the termination or otherwise;*
> >
> > *.2 the amount of payments made to the Contractor; and*
> >
> > *.3 the total amount which would have been payable for the Works in accordance with this Contract;*
>
> *.5 if the sum of the amounts stated under clauses 8.7.4.1 and 8.7.4.2 exceeds the amount stated under clause 8.7.4.3, the difference shall be a debt payable by the Contractor to the Employer or, if that sum is less, by the Employer to the Contractor.*

Employer's decision not to complete the Works

8.8 *.1* *If within the period of 6 months from the date of termination of the Contractor's employment the Employer decides not to have the Works carried out and completed, he shall forthwith notify the Contractor in writing. Within a reasonable time from the date of such notification, or if no notification is given but within that 6 month period the Employer does not commence to make arrangements for such carrying out and completion, then upon the expiry of that 6 month period, the Employer shall send to the Contractor a statement setting out:*

.1 *the total value of work properly executed at the date of termination or date on which the Contractor became insolvent, ascertained in accordance with these Conditions as if that employment had not been terminated, together with any amounts due to the Contractor under these Conditions not included in such total value; and*

.2 *the aggregate amount of any expenses properly incurred by the Employer and of any direct loss and/or damage caused to the Employer and for which the Contractor is liable, whether arising as a result of the termination or otherwise.*

.2 *After taking into account amounts previously paid to the Contractor under this Contract, if the amount stated under clauses 8.8.1.2 exceeds the amount stated under clause 8.8.1.1, the difference shall be a debt payable by the Contractor to the Employer or, if the clause 8.8.1.2 amount is less, by the Employer to the Contractor."*

20. These provisions (or their predecessors) were, of course, considered by the House of Lords in Melville Dundas v Wimpey [2007] 1 WLR 1136.

21. In that case:

(1) The final date for an interim payment was 16.5.03;

(2) On 22.5.03 receivers were appointed;

(3) The Employer determined the Contract on 30.5.03.

22. The Contractor contended that it was nonetheless entitled to be paid the sums which had fallen due for final payment before the insolvency. If this contention were right, then an Employer in this situation would be very exposed: paying out money to an insolvent contractor which might never be seen again.

23. The House of Lords focussed on clause 27.6.5.1 of the 1998 Edition of SBC with Contractor's Design. This provided:

> *"Subject to clauses 27.5.3 and 27.6.5.2 the provisions of this contract which require any further payment or any release or further release of retention to the contractor shall not apply; provided that clause 27.6.5.1 shall not be construed so as to prevent the enforcement by the contractor of any rights under this contract in respect of amounts properly due to be paid by the employer to the contractor which the employer has unreasonably not paid and which, where clause 27.3.4 applies, have accrued 28 days or more before the date when under clause 27.3.4 the employer could have first give notice to determine the employment of the contractor…"*

24. Their Lordships held (by 5/0) that this meant what it said: the contractor was not entitled to any further payment. They held (by 3/2) that this did not contravene Section 111 of the 1996 Housing etc. Act.

25. However, for present purposes, it is worth considering what their Lordships said about the proviso in clause 27.6.5.1.

    (1) Lord Hoffmann:

    > *"In the lower courts it appears to have been conceded that the effect of this clause was that upon determination by Wimpey, the interim payment was no longer payable. It had accrued less than 28 days before 22 May 2003, which was the date on which Wimpey could first have given notice of determination. Before the House, however, Mr. Howie submitted on behalf of the contractor that the words "which*

require any further payment…to the contractor" should be read to mean "which give rise to any further liability to make payments to the contractor" and have no application to a liability for interim payment which has already accrued. In my opinion this is not what the clause says. "Require any further payment" means require the employer to pay any more money. Mr. Howie's construction would make the proviso pointless, since the clause could not then apply to any amounts "properly due to be paid by the employer to the contract", whenever they accrued."

(2) Lord Hope:

"26. Mr. Howie said that once a sum had become due under the contract it could not cease to be due. The words "any further payment" should not be read as including an interim payment which the employer was already obliged to pay under clause 30.3.5 because the final date for its payment in terms of clause 30.3.6 had already passed by the date of the determination of the contractor's employment. The position would have been different if the employer had given a written notice to the contractor under the clause 30.3.4 not later than 5 days before the final date for payment stating the amount proposed to be withheld and the grounds for doing so. No such notice was given in this case. As the interim payment was an amount that the employer was already due to pay under the provisions of the contract before the determination of the contractor's employment, it was not a "further payment".

27. There are two problems with this argument. First, it involves reading into this part of the clause words that are not there. It seeks to confine it to payment which are not already due. But the word "any further payment" are unqualified. Their plain meaning is that the contractor ceases to be entitled to require any further payment whatever. As my noble and learned friend, Lord Hoffman, has said, their effect is that the contractor cannot require the employer to pay any more money. This is, of course, a temporary arrangement, as the reference to clause 27.6.5.2 at the beginning of the clause indicates. The employer cannot be required to pay any more money to the contractor in the meantime, pending the making up of the account as to the consequences of the determination referred to in clause 27.6.5.2.

28. Secondly, if the words "not already due" were to be read into this part of the clause, there would be no need for the proviso which permits the contractor, under certain conditions, to enforce any rights under the contract in respect of amounts properly due to be paid by the employer despite the determination of this employment. The purpose of the proviso

is to strike a balance between the contractor and the employer. The contractor's interest lies in enforcing the payment of sums which were already due before the determination. The employer's interest lies in retaining sums already due so that they can be set off against amounts which he can properly claim against the contractor in consequence of the determination of his employment under the contract. Thus the purpose of the clause, read as a whole, is to bring the contractor's right to enforce payment of any sums which have not already been paid to him by the employer to an end, except to the extent which the proviso permits, pending the making up an account under clause 27.6.5.2."

26. It remains to be seen what the courts will make of the new clause 8.7.3, which does not contain the proviso.

ADRIAN WILLIAMSON Q.C.

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