BEFORE : SCHIEMANN LJ; SEDLEY LJ; JACOB L.J : CA **:** 12th November 2003.

JUDGMENT : LORD JUSTICE JACOB :

1. This appeal involves a point of some importance in the world of building contracts. Mr Iain Wallace QC correctly forecast (in an article entitled *The HGCRA: A Critical Lacuna?* (2002) 18 Const. LJ 117) that a Scottish case dealing with it, ***SL Timber Systems v Carillion Construction*** [2001] BLR 516, *"seems certain to be reviewed at some future date by an appellate court in England."* And here it is. The point concerns the meaning of 111(1) of the Housing, Grants (Construction and Regeneration) Act 1996. It arrives via permission to appeal (given by Clarke LJ) from the decision of HHJ Anthony Thompson QC. Judge Thompson had dismissed an appeal from District Judge Murphy at Winchester County Court.

2. I go to the provision first:

"111 (1) A party to a construction contract may not withhold payment after the final date for payment of a sum due under the contract unless he has given an effective notice of intention to withhold payment.

The notice mentioned in section 110(2) may suffice as a notice of intention to withhold payment if it complies with the requirements of this section.

(2) To be effective such a notice must specify –

(a) the amount proposed to be withheld and the ground for withholding payment, or

(b) if there is more than one ground, each ground and the amount attributable to it,

and must be given not later than the prescribed period before the final date for payment."

3. The appellant defendants ("the clients") were having building works done on their cottage. The claimants were the builders. There was a written contract in a standard form provided by the Architecture and Surveying Institute ("ASI"). The clients were using the services of an architect. The builders were being paid on an interim basis pursuant to the scheme of the contract. (Section 109 of the Act required stage payments for works estimated at over 45 days, as these were.) Under the contract the architect is to issue an interim certificate, in practice based on his scrutiny of a bill presented by the builder. In this case there was a 7th interim certificate in the sum of £44,000 odd plus VAT. The clients accept that part of that is payable but dispute the balance amounting to some £27,000. The builders seek summary judgment for the balance.

4. The clients did not give *"a notice of intention to withhold payment"* before *"the prescribed period before the final date for payment."* The builders contend that it follows, by virtue of s.111(1) that the clients "may not withhold payment". So they seek summary judgment. The clients say they can withhold payment, that it is open to them by way of defence to prove that the items of work which go to make up the unpaid balance were not done at all, or were duplications of items already paid or were charged as extras when they were within the original contract, or represent "snagging" for works already done and paid for.

5. The rival arguments as presented in the courts below were for what can be termed "wide" and "narrow" constructions. The wide construction espoused by the builders is that once it shown that there is a certificate and no withholding notice, the certified sum must be paid – it cannot be withheld. The narrow construction is roughly to the effect that if work has not been done there can be no "sum due under contract" and that accordingly s.111(1) simply does not apply. As HHJ Humphrey Lloyd put it in ***KNS Industrial Services v Sindall*** (17th July 2000) "one cannot withhold what is not due."

6. Each construction has some basis in authority and learned writings. For the wide construction there is HHJ Bowsher QC in ***Whiteways Contractors v Impresa Castelli*** (2000) 16 Const. LJ 453, HHJ Humphrey Lloyd QC in ***KNS***, HHJ Gilliland QC in ***Millers Specialist Joinery v Nobles*** (3rd August 2000) and Keating on Building Contracts (7th Edn. 2001, para15-15H). For (or apparently for) the narrow construction there is HHJ Thornton QC in ***Woods v Hardwicke*** [2001] BLR 23, (arguably) HHJ Hicks QC in ***VHE Construction v RBSTB Trust*** [2000] BLR 187 and Lord Macfadyen in ***SL Timber Systems v Carillion Construction*** **[**2001] BLR 516 and Mr Wallace's article The views expressed in most of these cases are more or less oblique to the point directly in issue here. Moreover there were variants of the narrow construction, that is why I said "*roughly to the effect*". The variants were around the theme of whether the section merely prevented the raising of counterclaims or did it also cover

matters of abatement and set off? And what about a counterclaim based on work allegedly done badly?

7. I do not think these questions arise at all. This is because some of the debate seems to have been based upon an unspoken but mistaken assumption, namely that the provision is dealing with the ultimate position between the parties. That is not so as is pointed out by Sheriff J.A. Taylor in ***Clark Contracts v The Burrell Co***. [2002] SLT 103. He casts a flood of light on the problem.

8. Before going to what he said, it helps to go back to the contract in issue in this case. It identifies the parties, including the architect. It provides for interim certificates on a 14 day basis and a 14 day period for honouring certificates. It provides for the issue by the architect of interim certificates and a final certificate. The interim certificates, as is conventional, are on a "global" basis. By this I mean that each interim certificate takes account of the total work done to date and the total payments to date. It follows that if there is an error (e.g. a double charging) in an interim certificate, it can and should be corrected in the next. That is not so for the final certificate. This naturally raises the question; "what if that is wrong?" Notably the contract provides that "no certificate shall be taken as conclusive evidence that the work, materials or goods to which it relates are in accordance with this contract."

9. The time period during which matters can be checked before the final certificate is to be issued is much longer than that for interim certificates. That is as one would expect. In this case it is essentially three months. In practice therefore a final certificate is more likely to be accurate than an interim certificate. But nothing actually turns on this for it is common ground that s.111(1) applies to both interim and final certificates.

10. It was the debate about a final certificate which brought out the true nature of the provision. Suppose a final certificate included items not done or charged for twice and the time for serving a withholding notice has passed. An obvious concern would arise if the provision had the effect of not only requiring the client to pay for such items, but was conclusive. The section would override the contractual term specifically saying certificates are not conclusive. But the section does not say that failure to service a withholding notice creates an irrebuttable presumption that the sum is in the final analysis properly payable. It merely says the paying party "may not withhold payment …. of a sum due." This throws one back to the contract to find the answer to how the sum is determined and when it is due.

11. In this ASI contract, the sum is determined by the certificate. Clause 6.1 provides that "payments shall be made to the Contractor only in accordance with the Architects certificate." Clause 6.32 defines the sum – essentially the approved gross value of work done less retention and amounts previously paid. Cl. 6.33 says when it is to be paid: "the employer shall pay to the Contractor the amount certified within 14 days of the date of the certificate, subject to any deductions and set-offs due under the Contract." So it is not the actual work done which either defines the sum or when it is due. The sum is the amount in the certificate. The due date is 14 days from certificate date. The certificate may be wrong – the architect may (though this is unlikely because he will be working from the builder's bill) have missed out work done (which would operate against the contractor) or he may have included items not in fact done or items already paid for (which would operate against the client). In the absence of a withholding notice, s.111(1) operates to prevent the client withholding the sum due. The contractor is entitled to the money right away. The fundamental thing to understand is that s.111(1) is a provision about cash-flow. It is not a provision which seeks to make any certificate, interim or final, conclusive. Analysed this way one sees that there is something inconsistent about the clients' argument here. Their duty to pay now and the sum they have to pay arise only because of the certificate. Yet they wish to ignore the certificate to reduce the amount they have to pay.

12. All this becomes blindingly clear following Sheriff Taylor's analysis. He was dealing with a case like this, one involving a system of architect's certificates. This is what he said:
*"There was no dispute that the architect had issued an interim certificate. It therefore seems to me that the defenders became entitled to payment of the sum brought out in the interim certificate within 14 days of it being issued. In my opinion that is an entitlement to payment of a sum due under the contract. In order to reach the figure in the interim certificate one has made use of the contractual mechanism. To use the words deployed by Lord Macfadyen [in **SL Timber Systems**] in para. 20, the issue of an interim certificate was the occurrence of*

*"**some other event on which a contractual liability to make payment depended**". This situation falls to be contrasted with the position in SL Timber Systems where, before the adjudicator, there had been no calculation of the sum sued for by reference to a contractual mechanism and which gave rise to an obligation under the contract to make payment. There had been no more than a claim by the pursuers which claim had not been scrutinised by any third party. Thus, in my opinion, if The Burrell Co (Construction Management) Ltd wished to avoid a liability to make such payment because the works did not conform to the contractual standard they would be withholding payment of a sum due under the contract. In order to withhold payment they would require to give notice in terms of s.111(1) of the Act. No such notice was given.*

The interim certificate is not conclusive evidence that the works in respect of which the pursuers seek payment were in accordance with the contract (see cl. 30.10). That however does not preclude the sum brought out in an interim certificate being a sum due under the contract. The structure and intent of the Act, as I understand it, and accepted by the solicitor for the defenders, is to pay now and litigate later."

13. Sheriff Taylor earlier explained why Lord Macfadyen's case, was different. The contract there had no architect or system of certificates. The builder simply presented his bill for payment. The bill in itself did not make any sums due. What, under that contract, would make the sums due is just the fact of the work having been done. So no withholding notice was necessary in respect of works not done – payment was not due in respect of them.

14. Sheriff Taylor's analysis, once articulated, is obviously right. And it has a series of advantages:

    (a) It makes irrelevant the problem with the narrow construction – namely that Parliament was setting up a complex and fuzzy line between sums due on the one hand and counterclaims on the other – a line somewhere to be drawn between setoff, claims for breach of contract which do no more than reduce the sum due and claims which go further, abatement and so on.

    (b) It provides a fair solution, preserving the builder's cash flow but not preventing the client who has not issued a withholding notice from raising the disputed items in adjudication or even legal proceedings.

    (c) It requires the client who is going to withhold to be specific in his notice about how much he is withholding and why, thus limiting the amount of withholding to specific points. And these must be raised early.

    (d) It does not preclude the client who has paid from subsequently showing he has overpaid. If he has overpaid on an interim certificate the matter can be put right in subsequent certificates. Otherwise he can raise the matter by way of adjudication or if necessary arbitration or legal proceedings.

    (e) It is directed at the mischief which s.111(1) was aimed at. This mischief is mentioned in *Keating*. A report called the Latham report had identified a problem, namely that "main contractors were abusing their position to wrongfully withhold payment from sub-contractors who were in no position to make any effective protest." Actually the provision has gone further than just dealing with the position between main and sub contractors since it covers the position between client and main contractor too – but the main contractor will need paying himself so he can pay the sub-contractor. And he may have his own cash flow needs too. Incidentally s.109 (requiring stage payments for long contracts) is part of the same legislative policy.

15. The principal disadvantage of the statutory scheme from the client's point of view is that if he has overpaid he is at risk from insolvency of the builder. But the risk is one which he can avoid by checking the certificate and giving a timeous withholding notice. No doubt a good architect would inform a lay client about the possibility of serving such a notice – indeed the architect may (I express no opinion) have a duty to do so. Moreover the client may (again I express no opinion) have a remedy against the architect if the latter negligently issues a certificate for too much.

16. Thus I think the appeal should be dismissed. The clients must pay for the present. They are not without remedy if as a result they have overpaid. Preferably their remedy would be by the issue of an accurate final certificate by the architect rather than litigation of any sort. We were surprised to be told

that the architect has not done this even though this dispute has been going on for some two years – the sooner he does so the better. He will obviously have to consider the points which the clients were mistakenly seeking to raise in their defence to this claim. The fact that he is the brother of a director of the builders is, of course, irrelevant to his duties to his clients.

Lord Justice Sedley:

17. I respectfully agree with the entirety of Lord Justice Jacob's judgment. One reflects that the building in which we have sat to hear the case was almost not completed because of cashflow problems. The Office of Works had inevitably awarded the contract to the lowest bidder, a modest and undercapitalised Southampton firm. In spite of a series of generous interim certificates issued by the architect, George Edmund Street, the contractors stopped paying the stonecarvers and other subcontractors. By the time the building was finally completed, two and a half years behind schedule, they were insolvent. A statutory provision such as s.111 now makes would have done something to protect the stonecarvers from acting as unpaid bankers to the head contractors; and had the Office of Works been dilatory in paying the head contractors, Street's interim certificates would have preserved their cashflow too. There is, as Lord Justice Jacob demonstrates, nothing irrevocable about the s.111 process. It is designed simply to ensure that once a certificate is issued, payment follows unless proper notice of withholding is given. It has no legal effect, even presumptively, on the true incidence of liability.

Lord Justice Schiemann:

18. I also agree that this appeal should be dismissed for the reasons given.

Order: Appeal dismissed. Appellant to pay the respondent's costs of the appeal to be subject to detailed assessment if not agreed.

(Order not part of approved judgment)

Mr Julian Horne (instructed by Messrs Dunton Gregory for the Respondent

Mr Simon Hughes (instructed by Messrs Stitt & Co) for the Appellants