

JUDGMENT : HER HONOUR JUDGE FRANCES KIRKHAM. TCC. Birmingham. 14th November 2006

1. This is a Part 8 application by the claimant (TVC) for a declaration that a notice to withhold payment, dated 17 August 2006 and served by the defendant (BSL) on 18 August 2006, is invalid.
2. TVC is a building contractor. BSL is a single venture company incorporated in order to purchase and develop a site located at Brook Street Syston, Leicester and construct apartments.
3. I have witness statements from Mr Reeves (a director of TVC) and from Mr Babla, (a Chartered Quantity Surveyor and director of BSL).

Background

4. On 31 August 2004 BSL and TVC entered into a written contract. The contract is a JCT Standard Form of Building Contract With Contractor's Design 1998 edition incorporating amendments 1-5 and further amended by the Employer's Requirements ("the Building Contract"). The contract price is £1,945,124 and the contractual completion date is 16 May 2005. The Works are defined as the "Design and construction of 24 No. high quality apartments complete, including associated infrastructure, external works, drainage and statutory services". Mr Babla's firm, Aditi Babla Partnership, is the Employer's Agent under the Building Contract.

5. Various problems were experienced on the project and the 16 May 2005 completion date was not met. By the spring of 2006 both parties were making claims against the other: BSL claimed delay damages for non-completion; TVC left the site and claimed that practical completion had been achieved. Cross adjudications were commenced.

6. The parties in April met to attempt to resolve their differences amicably. Although the parties did not finally resolve their differences, they did agree a way forward. This was recorded in a Supplemental Agreement dated 7 April 2006. It was expressly stated that the Supplemental Agreement would be supplemental to the Building Contract, that the terms of the Building Contract remained binding and that, in the case of inconsistency, the Supplemental Agreement would prevail. The Supplemental Agreement includes the following provisions:

Clause 1 provided that an expert would be appointed to determine whether the works were practically complete and to set out what snagging works remained. The parties agreed that the expert's determination would be temporarily binding on them.

Clause 2 provided that, once the expert had made his determination, TVC was to prepare and issue a programme to carry out remedial and snagging work and to use reasonable endeavours to comply with that programme.

Clause 3 noted that TVC's liability for late completion was agreed in the sum of £220,000, payable upon agreement or determination of the Final Account pursuant to the Building Contract.

By clause 6, TVC was required to submit its draft Final Account within 4 weeks of the date of the Supplemental Agreement, and, thereafter the parties were to attempt to agree the Final Account.

Clause 7 included the following: "Neither party shall be obliged to make any payment to the other, whether by way of payment for the Works, damages for late completion or the release of retention until such time as the Final Account is either agreed between the parties or determined pursuant to the Building Contract".

7. In due course an expert, Mr John Riches, was appointed pursuant to Clause 1 of the Supplemental Agreement. In his decision dated 2 June 2006, Mr Riches observed: "the development is of high quality and is as good as the best I have seen in many years. The efforts that have been made in the design and workmanship and the selection of goods and materials reflect a high quality development". He determined that practical completion had been achieved by 22 May 2006, but that there were a significant number of snagging items outstanding (over 600 items).

8. On 9 June 2006 TVC submitted a programme which showed that they would make good the defects and complete the snagging items by the end of June 2006. In their covering letter, TVC said "... where there may be the necessity to replace a front door, and in particular we cite apartment 15, the procurement times are such that delivery will extend beyond the 21 day period and as such separate arrangements will have to be made to fix this within the defects liability period." They went on to say that they would begin work on 12 June.

9. Meanwhile, on 8 May 2006 TVC submitted its draft Final Account. BSL's solicitors replied on 17 May 2006, setting out BSL's position. It seemed that no agreement of the Final Account was going to be possible. BSL commenced an adjudication, in which they sought a declaration as to the value of the Final Account. The adjudicator, Mr Ribbands, having rejected TVC's jurisdictional arguments, published his decision on 30 June 2006. He declared, amongst other matters, that the value of the Final Account was £1,890,311.49.

10. On 26 May 2006 BSL commenced a further adjudication, claiming the outstanding balance of £57,425 from the delay damages payable pursuant to clause 2 of the Supplemental Agreement.. By his decision dated 17 August 2006, Mr Smith, the adjudicator, awarded this sum to BSL plus interest. By consent, judgment has been entered for this amount of money.

11. Mr Keith Roberts, a building surveyor, inspected the building on behalf of BSL on 26 June 2006 and prepared a report dated 5 July 2006. His report was limited to the finishing of exposed steel frame, creaking ceilings in some rooms, the condition and finishing of stairwells and leaks associated with shower screens. He concluded that there were defects in all of these areas.

12. On 28 June 2006 TVC's solicitors wrote to BSL's solicitors, on the question whether liquidated damages were payable, including the following:

"...The obvious intention discussed at the settlement meeting, is that the payment at that time would be a balance, taking account of all the sums due. Why else would the Final Account be the "trigger mechanism"? The intention was that sums due to my client would be set off against the agreed liquidated damages amount.

Accordingly I invite you to:

 1. *confirm acceptance of Mr Riches' determination and that the retention may be set off against sums otherwise due to your client when the Final Account is agreed/determined;*
 2. *confirm what, if any, values your client considers may be properly set off against the Final Account by reference to outstanding snags."*
13. On 24 or 25 July 2006, TVC issued interim application for payment number 21. In his statement prepared for this application Mr Babla says that he was not sure whether TVC was actually entitled to make that application for payment. He nevertheless considered the application, made an adjustment in respect of retention, and certified £57,425. He says he did so on the basis that TVC were due that money when work was complete, which included the making good of all defects. Mr Babla wrote to TVC by letter dated 1 August 2006 in relation to interim application number 21 including the following: *"We note that your application equates to 100% of the value of all works. So TVC's assertion must be that all works are 100% complete."* He went on to refer to clause 30.2B.1.1 of the Building Contract (which refers to "the total value of work properly executed") and said that BSL were considering whether TVC had *"proceeded to remedy and complete the defects."* He went on: *"Without prejudice to the above we enclose a copy of our Interim Certificate number 21..."* That valuation, issued on 1 August 2006, confirmed that the sum of £57,425 was due from BSL to TVC. The final date for payment was 22 August 2006.
14. BSL commissioned a report from Mr Jonathan White, a Chartered Quantity Surveyor. He reported on 16 August 2006. He concluded that there were a number of items of defective and incomplete work in almost all of the apartments and expressed the opinion that the total cost of remedying defects and completing work would be £168,144.
15. On 17 August 2006 BSL served a notice to withhold in the sum of £57,425. Mr White's report was attached to that notice. This is the withholding notice the subject of this application.

TVC's case

16. TVC say the notice to withhold is invalid and rely on four grounds. TVC's case is (1) that the sums which BSL seek to withhold represent damages in respect of the cost of making good defects, yet the ground relied on in the notice is failure by TVC to use reasonable endeavours to remedy the defects in accordance with the 9 June programme or failure to remedy defects in a reasonable time; accordingly, the damages claimed do not flow from the breach. (2) The damages sought include work on items not in Mr Riches' snagging list. (3) BSL is in effect seeking to go behind Mr Ribbands' determination of the Final Account by seeking to deduct matters that were required to be within a determined Final Account. (4) BSL's set off is in respect of a disputed and untested counterclaim and thus not permissible.

BSL's case

17. BSL's case is that no money is payable to TVC at this stage. A Final Account is not settled until the contractor has properly attended to all defects. Mr Ribbands' determination of the Final Account did not trigger an entitlement to payment of money at that stage. Even if it were the case that a sum were payable to TVC, the contract permits BSL to serve a withholding notice. In a Part 8 application where evidence is untested, it is not possible for the court to decide that the facts relied on in the withholding notice are incorrect. The BSL valuation dated 1 August reflected Mr Ribbands' decision and the question whether the works had been properly completed was expressly reserved.

Relevant contract clauses

18. In the Building Contract the Employer is defined as BSL and the Contractor as TVC.
19. Clause 16 of the Building Contract deals with practical completion and a subsequent defects liability period. It is common ground that the defects liability period ends in May 2007.
20. By clause 30.1.1.1, Interim Payments are to be made by BSL to TVC in accordance with Alternative B in Appendix 2. By clause 30.3.1.2 (which applies because Alternative B applies), applications for Interim Payment can be made "up to the day named in the Employer's statement of Practical Completion or to within one month thereafter". There is no such statement of Practical Completion but there is a finding by Mr Riches (in effect) that Practical Completion had taken place by 22 May 2006.
21. Clause 30.3.1.2 goes on to provide that "thereafter" (ie after expiry of one month from Practical Completion) application for Interim Payment can be made (i) "as and when further amounts are due to the Contractor" (ii) "after the expiry of the Defects Liability Period named in Appendix 1" or (iii) "on the issue of the Notice of Completion of Making Good Defects (whichever is the later)".
22. Clause 30.3.3 provides that, within seven days from his receipt of an Application for Interim Payment, the Employer's Agent must issue a written valuation "specifying the amount of the payment proposed to be made and

(amongst other matters) that "the final date for payment pursuant to a written valuation shall be 21 days from the date of issue of the written valuation."

23. By clause 30.3.4, not later than five days before the final date for payment of an amount due under clause 30.3.3, "the Employer may give a written notice to the Contractor which shall specify any amount proposed to be withheld and/or deducted from the due amount, the ground or grounds for such withholding and/or deduction and the amount of withholding and/or deduction attributable to each ground."
24. Clause 30.5 contains provisions for submission of a Final Account and a mechanism for adjustment of the Contract Sum. Clause 30.5.5 provides that the Final Account and Final Statement shall, within one month from whichever of the following is the latest date, (a) end of the Defects Liability Period; (b) the day named in Notice of Completion of Making Good Defects (c) date of submission of the Final Account, "be conclusive as to the balance due between the parties in accordance with the Final Statement except to the extent that the Employer disputes anything in that Final Account or Final Statement before the date on which, but for the disputed matters, the balance would be conclusive."
25. Clause 30.6 provides a mechanism for a notice of withholding to be served by the Employer:
 - 30.6.1 *"Not later than 5 days after the Final Statement becomes conclusive as to the balance due between the Parties in accordance with clause 30.5.5, or after the Employer's Final Statement becomes conclusive as to the balance due between the Parties in accordance with clause 30.5.8, the Employer shall give a written notice to the Contractor which shall specify the amount of the payment proposed to be made in respect of any balance stated as due to the Contractor from the Employer in the Final Statement or in the Employer's Final Statement."*
 - 30.6.2 *"The final date for payment of the said balance payable by the Employer to the Contractor or by the Contractor to the Employer as the case may be shall be 28 days from the date the Final Statement becomes conclusive as to the balance due between the Parties in accordance with clauses 30.5.5, or after the Employer's Final Statement becomes conclusive as to the balance due between the Parties in accordance with clause 30.5.8. Not later than 5 days before the final date for payment of any balance to the Contractor the Employer may give a written notice to the Contractor which shall specify any amount proposed to be withheld and/or deducted from such balance due to the Contractor, the ground or grounds for such withholding and/or deduction and the amount of withholding and/or deduction attributable to each ground."*

Discussion

26. Mr Riches said that the work was practically complete when he visited the site on 22 May. Mr Collie submits that, because neither party knew when practical completion had taken place, and given that no money would be payable until the Final Account was determined, it is entirely consistent with the contract read as a whole that TVC should apply for payment once the Final Account was determined.
27. TVC rely on the proposition that BSL did not expressly ask Mr Ribbands to determine the Final Account as at June 2007, the date when the defect liability period ends. Mr Ribbands decided that the value of the Final Account "is" £1.89m. He did not say that that would be the Final Account sum assuming all work is completed and snagged.
28. Mr Collie relies on the fact that Mr Babla did issue an interim payment certificate. Although Mr Babla now seeks to say that payment would not become due until work is complete, his actions in issuing the certificate and then the withholding notice indicate that he considered payment was due.
29. I accept Mr Henderson's submission that the Supplemental Agreement provided for a twin track approach: TVC would attend to snagging items and the parties would proceed to deal with the Final Account.
30. Clause 2 of the Supplemental Agreement provided that damages for delay would be payable upon determination of the Final Account, but there is no express provision for immediate payment of any other sum once the Final Account had been determined. Clause 7 provides only that neither party shall be obliged to make any payment to the other until the Final Account is agreed. In other words, the Supplemental Agreement defines an earliest date for payment of the Final Account sum but does not state that sums will in fact be due on that date. As Mr Henderson submits, most of the mechanisms in the Building Contract survive, including those in the clauses to which I have referred. The provisions of the Supplemental Agreement do not sweep away clause 30.5.5 and the other Final Account provisions in the Building Contract.
31. In my judgment, on a true construction of the contract (ie the Building Contract and the Supplemental Agreement) the parties had not agreed that payment would become due once the Final Account had been determined. By the Supplemental Agreement, the parties had expressly agreed when delay damages were to be paid but took a different approach to payment of the Final Account sum, ie agreeing only the earliest date for payment. This suggests that the parties did not intend that determination of the Final Account would trigger a right to immediate payment.
32. The final passage of the letter from TVC's solicitors dated 28 June 2006 (which I have quoted earlier) seems to me to indicate that, at that stage, TVC proceeded on the understanding that BSL would be entitled to set off sums in respect of outstanding snagging against the Final Account sum: .

Accordingly I invite you to:.... 2. confirm what, if any, values your client considers may be properly set off against the Final Account by reference to outstanding snags."

At that stage, the parties were awaiting Mr Ribbands' decision as to the Final Account sum and both knew that TVC still had work to do.

33. It is unlikely that the parties intended that TVC be entitled to immediate payment for work which had not been properly executed.
34. The surviving clauses in the Building Contract make it clear that no payment is due until the latest of the three events set out in clause 30.3.1.2. As the latest of these events has not yet occurred, payment is not yet due.
35. In all the circumstances, in my judgment, the fact that the Final Account sum has been determined does not mean that payment of that sum is due.
36. Mr Babla indicated in his letter of 1 August 2006 that he proceeded on the assumption that TVC's application assumed that all works were 100% properly executed, but that was not in fact the position: TVC still had work to complete. It seems to me that the fact of the issue of an interim certificate (on the basis of that express proviso that TVC still had to remedy and complete work and that the certificate had been issued without prejudice to BSL's position on that) does not displace the parties' contractual rights under the payment provisions of the Building Contract.
37. In my judgment, on a true construction of the Building Contract and Supplemental Agreement, and notwithstanding the issue of the interim certificate, TVC were not entitled to payment in August of the certificated sum.
38. However, even if – contrary to my view – the Final Account determination had entitled TVC to make an application for payment, the provisions of both clause 30.3.4 (in the case of an Interim Payment) and clause 30.6.2 (in relation to the Final Account) make it clear that BSL was nevertheless entitled to serve a withholding notice. The provisions of those clauses were not displaced by the Supplemental Agreement.
39. The matters contained in the reports of Mr Roberts and Mr White have not been tested. There is no mechanism for doing so within the Part 8 procedure which TVC have chosen. As Mr Henderson submitted, it is not open to me to conclude that the facts relied on in the withholding notice are incorrect. For the purposes of this hearing only, I proceed on the assumption that those reports are accurate.
40. I turn now to the four grounds on which TVC rely.

TVC's ground 1

41. The notice to withhold is said to be served pursuant to section 111 Housing Grants, Construction and Regeneration Act 1996 and clause 30.3.4 of the Building Contract. It refers to the facts that, on 9 June 2006, TVC had prepared a programme for completion of remedial work by 30 June 2006 and had failed to make good, remedy and/or complete the work on the snagging lists. It alleged that that failure amounted to a breach of clauses 2 of the Supplemental Agreement and 16.1 of the Building Contract. The ground on which £57,425 is sought to be withheld is as follows: *"The Employer is entitled to withhold a sum for the cost of making good the outstanding defects and completing incomplete work (pursuant to the contract or its common law rights). The Employer relies on the independent report of Jonathan White, a quantity surveyor, which demonstrates that the cost of making good/remediating outstanding defects and completing incomplete work will exceed the amount of the Interim Certificate."*
42. TVC's case is that BSL's ground for withholding is in truth a failure by TVC to use reasonable endeavours to remedy the defects in accordance with the programme or a failure to remedy the defects in a reasonable time. Thus, the damages claimed by BSL do not flow from the breach.
43. I reject TVC's argument as artificial and contrived. It does not seem to me to be appropriate to construe the withholding notice as nicely as TVC seek to do. In my judgment it would be inappropriate to apply fine textual analysis to a notice which is intended to communicate to the other party why a payment is not to be made. It is clear that BSL withhold payment because (as TVC do not challenge) TVC have not completed work or remedied defects. If it were the case that TVC had attended to all incomplete or defective work, so that BSL's complaint was in reality about delay in attending to snagging items, then there might be some force in TVC's argument. However, the reality is that TVC have not yet remedied defects and completed outstanding work.
44. BSL are holding retention money of about £55,000. However, given Mr White's estimate of the cost of completing outstanding work, it would in my judgment produce an inequitable result if the Final Account balance were to be paid now when TVC had not yet completed their work.

TVC's ground 2

45. TVC complain that the damages sought to be withheld include sums in respect of items not on Mr Riches' snagging list.
46. BSL say that it is clear from Mr Riches' list that, in respect of a significant number of items, he concluded that if an item were an agreed variation then it was not a defect; otherwise it was. BSL's case is that most, if not all, of those items were not agreed variations and thus, on Mr Riches' analysis, a defect. The evidence on this point has not been tested.
47. BSL accept that they rely, in the withholding notice, on a very small number of defects (worth a total of about £2,000) which are not on Mr Riches' list. They rely on the figure identified by Mr White (£168,144) as the cost of remedying defects and completing work. In the context here, I accept BSL's description of those items in the withholding notice which are not on Mr Riches snagging list as being de minimis.

48. It is not possible, in Part 8 proceedings, to test the evidence. The available evidence suggests that, even if one deducted the estimated cost of items not in Mr Riches' list, there may still be a substantial cost of remedying defects, and that cost may be in excess of the sum now claimed by TVC. The fact that a small number and value of items on Mr White's list are not on Mr Riches' list does not render the withholding notice invalid.

TVC's ground 3

49. TVC say that Mr Ribbands determined the Final Account. BSL seek to go behind that determination by seeking to deduct in respect of matters which were required to be within a determined Final Account, namely deductions for defects not required to be remedied by TVC. By clause 30.5.3.4, the Final Account is deemed to include any deduction in relation to defects under clause 16.2 and 16.3. Had BSL wanted to make any deduction in relation to outstanding snagging, they should have raised this within the Final Account procedure. It is not open to BSL to set off against the Final Account a sum which should have been included in the Final Account. In this respect, Mr Collie relies on the judgment of Ramsey J in *William Verry -v- London Borough of Camden* [2006] EWHC 761 (TCC).
50. BSL point out that TVC were obliged, pursuant to the Supplemental Agreement, to complete the snagging work. TVC have failed to do this work.
51. I am not persuaded by TVC's arguments. They rely on the Final Account determination as giving rise to a right to immediate payment. As I have set out above, in my judgment mere determination of the Final Account does not trigger an obligation to pay. In any event, TVC are unable to overcome the contractual provisions which expressly entitle BSL to give TVC a withholding notice no later than five days before the final date for payment of any balance due to TVC. Even if there had been an entitlement to payment, BSL served its withholding notice in time.

TVC's ground 4

52. TVC say that BSL are, in effect, attempting to set off a disputed and untested counterclaim against a sum found by an adjudicator. I reject that argument. First, Mr Ribbands did not find that a sum was due. His finding did not result in TVC being entitled to payment. Secondly, it seems to me in any event incorrect to characterise BSL's claim to be entitled to withhold sums as "*a disputed and untested counterclaim*". Mr Riches has found a very large number of snagging items. TVC do not suggest that they have completed work. Mr White's report and that of Mr Roberts suggest that TVC has failed properly to complete work and to carry out remedial work possibly to a substantial value.

Conclusion

53. TVC is not entitled to a declaration that the withholding notice dated 17 August 2006 is invalid.

Mr Peter Collie of Counsel (instructed by Charles Russell LLP) for the Claimant
Mr Simon Henderson of Counsel (instructed by HBJ Gateley Wareing LLP) for the Defendant