THE OBLIGATION TO PAY A NOTIFIED SUM WHERE THE CONTRACTOR IS INSOLVENT

By Thomas Saunders

The general rule created by section 111 of the Housing Grants, Construction and Regeneration Act 1996 is well known: the notified sum, in the absence of a pay less notice, is to be paid without set-off or deduction.

Although this is capable of causing problems for an employer in the short term, any overpayments can usually be corrected in future payment cycles (whether interim or final) or by a true value adjudication (following *S&T (UK) Ltd v Grove Developments Ltd* [2018] EWCA Civ 2448, [2019] Bus LR 1847).

But what about when the contractor is or becomes insolvent? The concern for an employer here is obvious: money paid over to an insolvent contractor is liable to disappear into the general fund and be distributed at pennies on the pound, leaving the employer unable to recover the full value of any overpayment or cross-claims. There may not be any future payment cycles, and even if there are such cycles or a true value adjudication, it may be impossible to make a full recovery. Unlike the normal scenario, it will not simply come out in the wash.

What, therefore, can an employer do?

Giving a pay less notice.

The first solution is the obvious one: to be scrupulous about giving pay less notices in respect of any cross-claim, or if there are any other grounds to resist payment.

However, it may not always be possible to give a timely pay less notice – suppose the facts which would entitle the employer to do so do not arise until after the deadline (or arise before the deadline but do not come to the employer's attention until afterwards).

In any case, in practical terms, it is not unheard of for an employer simply to fail to put in a pay less notice, or to miscalculate the period for doing so, through inadvertence or otherwise.

While taking care over payment notice and pay less notices is the first and most important step, therefore, it is necessary to consider what comes next.

Section 111(10) of the HGCRA.

Section 111(10) of the Act provides that the obligation to pay the notified sum does not apply if:

(a) The contract provides that if the contractor becomes insolvent, no sum need be paid in respect of the payment; and

(b) The contractor has become insolvent after the last date for giving a pay less notice.

That provision is not comprehensive. In particular:

- It will not assist where the contractor's insolvency precedes the last date for giving a pay less notice. The rationale appears to be that an employer in that situation can protect its position by giving a pay less notice. As suggested above, this may not always be the case.

- It will also not assist in any scenario where the contract does not contain a provision of the sort set out at (a) above. This is less likely to be an issue in contracts concluded on standard forms, but may be an issue in informal contracts. No such provision will be implied by Part II of the Scheme for Construction Contracts.

See further ***Practice Note: Payment in construction contracts: Construction Act 1996, section Insolvency and section 111: Scope of section 111(10) considered.***

Even if section 111(10) is inapplicable, however, that is not necessarily the end of the matter for an employer facing a notified sum claim from an insolvent contractor.

Resisting enforcement.

The next option is to resist enforcement of any adjudication decision by reference to the claiming party's insolvency, and in particular by reliance on the doctrine of insolvency set-off.

The principle that the claiming party's insolvency can be relied upon to resist summary judgment in adjudication enforcement proceedings, where the other party has a cross-claim amounting to an insolvency set-off, is well established. It was considered by the Court of Appeal in *John Doyle Construction Ltd v Erith Contractors Ltd* [2021] EWCA Civ 1452, [2021] Bus LR 1837, in light of the Supreme Court's decision in *Bresco Electrical Services Ltd v Michael J Lonsdale (Electrical) Ltd* [2020] UKSC 25, [2020] Bus LR 1140.

In *John Doyle*, the adjudicator had determined the net balance in a final account dispute. The resisting party (Erith) maintained that it had a cross-claim, and that on a true valuation the claiming party (JDC) had been overpaid.

Coulson LJ concluded, notwithstanding dicta in Bresco which might have been thought to point the other way, that JDC was not entitled to summary enforcement. The decision of the adjudicator was a provisional assessment only:

> *"where the decision remains provisional [...] 'it is clear that the rights under the insolvency regime prevail'"*
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> —*John Doyle* at paragraph 93, approving *Meadowside Building Developments Ltd v 12-18 Hill Street Management Company Ltd* [2019] EWHC 2651 (TCC) at paragraph 56.
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> *"I do not consider that the provisional finding of an adjudicator, even on a single final account dispute where no other significant non-contractual or other contractual claims arise, can be treated as if it were a final determination of the net balance, in circumstances where the other party maintains its set-off and cross-claim. It is not a question of security; it is a question of the insolvent company's cause of action being for the net balance only."*
>
> —John Doyle at paragraph 98.

The entitlement following insolvency was to be paid the net balance, and that *"must in law be the balance as finally determined, not as per the adjudicator's provisional view": John Doyle* at paragraph 99. It follows that a resisting party can rely on insolvency set-off even if the cross-claim in question was rejected on the merits by the adjudicator.

Two further possibilities.

There are two further possibilities which merit consideration.

The first is to rely on an insolvency set-off as a defence during the adjudication itself. There are various technical rules governing the application of insolvency set-off that cannot fully be considered here, including as to the timing of the relevant claims. If it is in principle possible, however, it may in a suitable case be cheaper and more effective to do so rather than to wait until the enforcement stage.

An adjudicator can generally consider an insolvency set-off by way of defence, as part of his or her general jurisdiction to consider any available defence: Bresco at paragraph 63. This includes the possibility of simply making a declaration as to the value of the main claim and leaving the value of the insolvency set-off to be determined separately: ibid.

The ordinary rule is that there is no set-off against a notified sum. Insolvency set-off is different in kind from other set-offs (cf. *Bresco* at paragraphs 27 and 29), but it would nevertheless be necessary to construct an argument that it should be an exception to this rule. Such an argument might be along the lines that the obligation to pay a notified sum is of a *"provisional"* character (*S&T* at paragraph 97), and that, just like the provisional determinations of an adjudicator (as to which, see *John Doyle* above), it cannot be allowed to prevail over the insolvency regime.

However, it would be necessary to confront the implications of section 111(10) for such an argument.

The second possibility is to seek to restrain any notified sum adjudication by injunction.

In *Bresco*, the Supreme Court overturned the Court of Appeal's decision that adjudication during insolvency would generally be futile and so should be restrained by injunction. This was for essentially two reasons:

- A party has a statutory and contractual right to bring a dispute to adjudication. The court should not interfere with that as a matter of principle: paragraph 59.

- The adjudicator's speedy determination of the issues (whether on the main claim alone or any cross-claim advanced by way of set-off) may be of *"real utility"* even if the decision is not as such enforceable: paragraph 63.

It is far from obvious that the latter reason would apply to a notified sum adjudication. The adjudicator does not consider the underlying facts, and so does not contribute to resolving the 'real' dispute. It is at least arguable, therefore, that an adjudication on a notified sum dispute is futile unless it can be enforced.

However:

(a) If, as suggested above, it is possible for the responding party to rely on an insolvency set-off in the adjudication, it may be that the process is not futile if the adjudicator can consider the merits of that set-off, which may be of some utility to the parties on the basis explained in *Bresco*.

(b) In any case, futility does not dispose of the former objection, described in *John Doyle* at paragraph 86 as the *ratio* of *Bresco*. The fundamental point is the statutory and contractual right to make a reference at any time.

Conclusion.

The best-established and safest routes to avoiding payment of a notified sum to an insolvent contractor are the service of a timely pay less notice; reliance on section 111(10) where it applies (including ensuring that any contract contains an appropriate clause to engage that section); and resisting enforcement following any adjudication. These routes are not comprehensive, however, and it may be that certain claims slip through the cracks.

There may be two more speculative routes. The first is to seek to rely on insolvency set-off as a direct defence to the notified sum claim. The second is to seek to restrain any adjudication by injunction. Whether those would find favour remains unclear.

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