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Welcome to the latest edition of **Archor's Aggregate** newsletter.

This edition is a 'terms and conditions special' – please try and contain your excitement. We've taken a look at some of the typical issues and queries we see with regard to contractual terms, and tried to shed some light on them. So:

- Lucy considers different types of limitation of liability clauses, and whether there can be such a thing as too small a limit.
- Jessica looks at pay when paid clauses in the context of insolvency – an issue particularly in focus at the moment with the continued high rate of business failures in the industry.
- Molly considers the risks of not getting payment provisions right from the outset, including taking a look at last year's Court of Appeal decision in A&V Building Solutions v. J&B Hopkins.
- And finally, Megan discusses another payment provision issue that is commonly an issue with terms and conditions drafted to link payment to invoices – a case last year seems to have finally settled on whether this can be done or not.

We hope you enjoy this edition, and as ever, if you have any ideas for future articles or other feedback, do please get in touch.

Oli, Editor-in-Chief

LIMITATIONS OF LIABILITY?

IS THERE TOO SMALL A LIMIT?

Limitation of liability clauses are commonly negotiated to protect parties from unexpected or excessive damages in the event of a breach of contract. This helps parties to construction contracts and appointments manage their risk level and financial exposure. Sometimes, limitations of liability are required by professional indemnity insurance providers in order to offer sufficient cover for a party.

This article looks at three common types of limitations of liability: contractual caps, net contribution clauses, and exclusion clauses.

Caps on liability

Overall limits of liability, often referred to as 'caps', are fairly common in appointments. However, it can often be difficult to reach an agreeable compromise, because a consultant will want to limit its liability as much as possible, whereas the client will want to maximise the potential recoverability of damages. Consultants often deem it not commercially sensible to accept a high level of exposure where the fee they are receiving for their services is disproportionately low.

Where a low cap can be negotiated, though, is that necessarily a good idea? You may (reasonably) assume that an incorporated cap on liability would indeed cap a consultant's liability at the cited level however low that may be: after all, parties are generally free to contract as they see fit. However, it may come as a surprise that this is not always the case.

A case from 2012 - *Trustees of Ampleforth Abbey Trust v. Turner & Townsend Management Limited* - concerned the appointment of construction consultants Turner and Townsend as project managers for a development at Ampleforth School. T&T were deemed negligent by the court for failing to procure a contract with the contractor, resulting in an inability for Ampleforth to recover liquidated damages of £750,000 from the contractor.

T&T's appointment contained a cap on liability at the lesser of £1,000,000 or the total fee paid under the appointment (which in the event was £111,321). The terms of the appointment also required T&T to maintain professional indemnity insurance cover at £10,000,000.

The court found that the cap on liability was of no effect, and therefore Ampleforth were able to access T&T's full PI cover. This was because the cap did not pass the 'reasonableness' test under the Unfair Contract Terms Act 1977 (usually known as 'UCTA'). The primary reason for this was that T&T were required to maintain a level of PI cover far in excess of the cap incorporated into their appointment, and therefore such a low cap could not be justified. The judge commented that the fee for that insurance would have no doubt been incorporated into T&T's overall fee for their services. There was no valid explanation as to why such a low cap on liability was incorporated into the contract, and so the judge rejected it altogether.

Net contribution clauses

Net contribution clauses are sometimes requested by parties in order to limit their liability to the amount which would be apportioned by a court in circumstances where two or more parties are jointly liable for the same loss or damage. In the absence of a net contribution clause, the client/employer could recover 100% of its loss or damage from just one of the jointly liable parties.

From the employer's perspective, however, net contribution clauses are often not acceptable. This is because if, for example, the contractor who was 70% liable became insolvent, the employer would only be able to recover 30% of its loss and damage suffered. As such, net contribution clauses are not routinely included within consultant appointments as they are often deemed too risky for the client/employer.

Exclusion clauses

Sometimes, a party may request the exclusion or cap of a specific type of loss for clarity, such as loss of profit or consequential losses. This is much more infrequent than those mentioned above, however. Also note that a contract cannot limit liability for certain things, such as fraud, personal injury, or death,.

Exclusion clauses have to be clear and unambiguous. In the 2015 case of *Persimmon Homes v. Ove Arup & Partners*, the court held that the wording "liability for any claim in relation to asbestos is excluded" was sufficiently clear to exclude liability for asbestos. Mr Justice Stuart-Smith acknowledged within the same judgment that "there has been a shift in the approach of the Courts to limitation and exclusion clauses" and that there is "an increasing recognition that parties to commercial contracts are and should be left free to apportion and allocate risks and obligations as they see fit, particularly where insurance may be available to one or other or both parties to cover the risks being so allocated".

Despite this more liberal approach, care should always be taken when incorporating exclusion clauses, otherwise parties face the contra proferentem rule being implied where there is a question over the interpretation of a commercial contract. This essentially means that where there is doubt about the interpretation of a clause, the words will be construed against the party that proposed them.

Conclusion

Parties wishing to incorporate a cap on liability into a construction contract should take care to ensure that it is not disproportionately below the PI insurance level they will be maintaining for the project in question, otherwise they risk the cap being disregarded entirely. Additionally, any exclusions of liability should be drafted clearly to have the desired effect.

We frequently deal with issues arising from exclusion clauses as well as ensuring the balance of risk is properly allocated at the contract formation stage. If you require any assistance, we'd be delighted to hear from you.

Lucy Day
Associate

PAY WHEN PAID ON INSOLVENCY

You may already know 'pay when paid' provisions in construction contracts (that we have all seen!) are prohibited under the Housing Grants, Construction and Regeneration Act 1996 (as amended) (the "Construction Act"). However, did you know that the position changes if another party upstream is insolvent?

When a party involved in a construction project becomes insolvent, whether through liquidation, administration, or other insolvency proceedings, it can have significant implications on payment for those downstream. Every party in a construction project wants to protect themselves from these implications. But what is the best way to do that? Well one effective way is to take advantage of the insolvency exception on the prohibition of pay when paid clauses.

Section 113 of the Construction Act tells us that *"A provision making payment under a construction contract conditional on the payer receiving payment from a third person is ineffective, unless that third person, or any other person payment by whom is under the contract (directly or indirectly) a condition of payment by that third person, is insolvent".*

But be warned – this does not mean that any time a party upstream becomes insolvent you do not have to pay downstream! Firstly (and most importantly) you have to have a pay when paid on insolvency clause in your downstream contract. You will not be able to rely on the section 113 insolvency exception without it! Including this clause in your sub-contracts may sound unfair on the other party – but it's important to remember you may not have to rely on it, and the clause will only be relevant if the employer (or maybe the contractor) goes bust. Think of it as an insurance policy. If you choose not to include the clause in your sub-contract, and the employer becomes insolvent, you could be liable for your subbie's large bill while being paid very little (if anything) yourself.

The other factor to consider is the validity of your pay when paid on insolvency clause. One of the leading cases on this point is *William Hare Limited v. Shepherd Construction Limited* [2009], which was upheld in the Court of Appeal. Hare was Shepherd's sub-contractor on a large development in Wakefield. Hare had a valid claim for works completed under the sub-contract. However, Shepherd withheld the money owed to Hare when the employer went into administration by relying on a pay when paid on insolvency clause in the sub-contract.

The clause incorporated the four specific insolvency scenarios set out in the Construction Act. However, Shepherd failed to take into account a change in the law when drafting the sub-contract: five years before the parties entered into the sub-contract, the Insolvency Act 1986 was amended to include two additional ways a party could enter into administration, including the 'out of court' route.

Unfortunately for Shepherd, the employer had used this out of court route to enter administration. The court therefore held that the pay when paid on insolvency clause was not effective, as Shepherd had not specifically included a provision for this type of administration in the clause that was within the contract.

The moral of the story is that you should always be including a pay when paid on insolvency clause in your sub-contracts – or at least giving it serious thought. It's always better to have the clause and not rely on it, rather than be on the end of an upstream insolvency without it, and generally they are accepted in most cases. The protection these clauses offer are particularly important when we are seeing construction insolvencies left right and centre.

You should also bear in mind the cautionary tale of *Hare v Shepherd* when drafting your sub-contracts. It's not enough to only have the clause, you need to make sure it is accurate and effective for the type of insolvency events that may arise. If you are concerned about any pay when paid on insolvency clauses in your sub-contracts, or want to discuss introducing them, you know where we are…

Jessica Garrod
Trainee Solicitor

PROBLEMS WITH PAYMENT **PROVISIONS**

As you will (or should!) know, the Housing Grants, Construction and Regeneration Act 1996 as amended (the "Construction Act"), requires almost all construction contracts contain a sufficient procedure for determining when payments become due, how much is owed and a final date for payment of the same. In particular, the Construction Act provides that the parties may agree how long the period between the due date and the final date for payment will be.

The aim of the Act in this respect is to create a uniform mechanism which provides frequent and fair payments across the construction industry and within each construction project. In the event that parties are unable to agree on these terms, or they are not compliant with the Construction Act, the Scheme for Construction Contracts Regulations 1998 as amended (the "Scheme") will be implied into the contract.

If a construction contract does not incorporate any payment terms, the entirety of the payment provisions within the Scheme will apply. If the contract complies in part with the payment terms under the Act, then those provisions that do comply with the Act will continue to take effect with any missing provisions will be implied into the contract by the Scheme. Any non-compliant provisions will be substituted by the appropriate payment provisions within the Scheme.

In some instances, there may be conflicting provisions within the same contract. Where there is a disparity as to which set of payment provisions are relevant, it can cause many issues between the contracting parties. For example, there may be a payment schedule appended to the contract, which does not marry up to the terms within the payment clause in the contract itself. The former may suggest an interim application is to be submitted on a particular day each month, whereas the latter may suggest there is an interim valuation date, and the application should be submitted 7 days prior. A common question for the parties is therefore which is the correct date to use?

The Court of Appeal in *A&V Building Solutions Limited v. J&B Hopkins Limited* [2023] illustrates the problems which parties may run into when their contract does not contain a clear and definitive payment mechanism. In this instance, it led to several sets of proceedings. J&B were the main contractor, while A&V were the sub-contractor. The relevant provisions within the contract were as follows:

"9.2. It is a condition precedent to payment that the Sub-Contractor shall make monthly applications.

9.3. The payments shall be in accordance with Appendix 6."

Appendix 6 contained a payment schedule, within which the heading of the first column read *"Date which Sub-Contractors to Issue Application to J&B". The dates in this first column were uniformly 10 days before the 'Valuation Date' in the second column, which was always the last day of each month. Appendix 6 stated that "For the avoidance of doubt if applications are not received from the Sub-Contractor 7 days prior to the Valuation Date then the Sub-Contractor shall not be entitled to any payment….".*

A&V's interim application 14 was dated 21 March 2022, which fell on a Sunday, so application 14 was issued the following day (being Monday 22 March). This was one day after the date specified in the column listing dates which the sub-contractor was to issue an application. J&B's position was that the application was invalid as A&V had missed the date listed in the first column, while A&V sought to rely on the fact it was not later than 7 days before the Valuation Date.

The Court of Appeal found that Clauses 9.2 and 9.3 formed general provisions of J&B's standard sub-contract, but Appendix 6 was a bespoke schedule agreed between the parties and specifically implemented for the sub-contract with A&V. As such, it was held that where there is irregularity between the contractual provisions, the bespoke provision was expected to overrule the general provision. It was therefore decided that interim application 14 was valid, and could have been issued up to 7 days before the last date of the month.

Another problem which commonly arises is when payment schedules 'run out'. In the case of *Grove Developments Ltd v. Balfour Beatty Regional Construction Limited* [2016], the parties entered into an amended JCT Design and Build Contract, one such amendment was that there would be 23 interim valuation dates, effectively meaning 23 payment cycles. After the 23 payment cycles had passed, the works remained unfinished. Balfour Beatty (as the contractor) continued works, and submitted a 24th application.

The Court held that Balfour Beatty was not entitled to further interim payments beyond those set out in the schedule to the contract, despite the fact that the works were not complete. It said that the right to interim payments was subject to the parties' ability to agree the frequency of payments, and provided that there was an adequate mechanism, which there was in this case, it didn't matter that interim payments didn't necessarily cover the entire period of works. Although it meant that Balfour Beatty would have to wait until the final payment for further sums, effectively the court found that the fault was with Balfour Beatty in their failure to negotiate protective terms in the Contract to cover interim payment applications should the works continue (as they did) beyond the initially envisioned completion date.

The key takeaway is that parties need to have consistent, forward-thinking and uniform terms throughout the entirety of the contract. This extends to bespoke schedules, in order to avoid missing the deadlines for applications and/or payment notices, and not creating an unchangeable limit on the number of payment cycles. With a little thought upfront, payment provisions can be made clear for both parties, avoiding costly errors and disputes down the line.

Molly Lockerbie
Trainee Solicitor

PAYMENT & INVOICES

WHAT TO DO?

Last year there were two cases known as *Lidl v. Closed Circuit Cooling* (t/a 3CL) which attracted a lot of attention. One of the issues raised was as to the validity of 3CL's application for payment, and the validity of a payment notice served by Lidl, which in turn raised the question of whether a final date for payment could be linked to the issuing of an invoice.

As part of the Framework Agreement entered between Lidl and 3DL, the parties were able to enter individual work orders, each of which constituted a separate contract. In respect of one of those, 3CL submitted an application for payment in the sum of £781,986.22 ('AFP19'). Lidl submitted that this was an invalid application for payment as it failed to comply with various requirements of the contract, one being that it did not identify the milestone for which the payment was sought. Lidl subsequently issued a payment notice valuing the works at nil ('Pay-7').

In April 2023 3CL referred a dispute to adjudication on the basis that Pay-7 was not a valid payment notice, but instead it was an invalid pay less notice served without a prior payment notice. As part of their submissions, Lidl's argued that the final date for payment was conditional on receiving a valid VAT invoice from 3CL and this issued was raised against before the court.

Linking the final date for payment to the provision of a VAT invoice is a relatively common thing to see. A typical clause might look like this: *"The final date for payment shall be 28 days from its due date or the date of receipt by the Employer of an appropriate VAT invoice, whichever is the later".*

However, *Lidl v. 3CL* confirms this kind of provision is not acceptable: while the parties have wide discretion as to the circumstances in which a payment becomes due, the discretion is much narrower when it comes to deciding the period between the due date and the final date for payment. The court said that the discretion there was limited only to the period in question, and did not allow the introduction of new triggers or hurdles, such as the issue of an invoice.

The court's decision does make practical sense. The provision of a valid invoice could vary from month to month which in turn would make it difficult in practice to adhere with different payment terms dependant on when an invoice is raised (for example knowing when a pay less notice could be issued). Even when the final date for payment is linked to a fixed period, we see many disputes arise, so the uncertainty with comes with the issue of a VAT invoice would complicate matters relating to payment even further.

Where contracts still link the final date for payment to the issue of an invoice, it is clear in light of *Lidl v. 3CL* that this will be non-compliant. As such, the relevant provisions of the Scheme for Construction Contracts 1998 as amended (the 'Scheme') will supplement the non-compliant payment term (and any other defective payment terms in the contract). The Scheme provides that the final date for payment will be 17 days from the date that payment becomes due, which could mean that a payment must be made (and a pay less notice served) much earlier than one party expects.

This is when chaos often ensues: when one party to a contract is working to defective contractual terms, and the other party is adhering to those under the Scheme. It is important that all parties to a construction contract have a clear understanding of the payment terms, whether they are following compliant terms under the contract, or defaulting to those under the Scheme, so they can issue relevant notices on time. Making sure provisions are drafted from the outset that are compliant with the Construction Act is therefore vitally important.

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