MAYER·BROWN

Legal Update
February 2019

# Legal developments in construction law

## 1. Remind me – what does practical completion look like?

Practical completion is a critical moment in a construction project, with important consequences. In ***Mears v Costplan*** achieving practical completion under an agreement for lease meant that Mears, a property management company, had to take on a 'very expensive' 21 year lease of student housing. If it was not achieved by a long-stop date, Mears could terminate the agreement. There was a dispute about practical completion but how should the critical moment be identified?

The court noted that practical completion under the agreement for lease was no different from practical completion under the building contract, was not defined and should therefore be given its usual, building contract, meaning. The judge adopted Keating's textbook statement of principle that (in summary) the works can be practically complete even if there are latent defects, but not if there are patent defects. Practical completion means the completion of all construction work but the architect (or contract administrator) has a discretion to certify practical completion where very minor items of work are incomplete.

The judge added his own observations, that practical completion is not just about the extent of the work done but also, at least in some respects, its quality. The works need not, however, be in complete conformity with the contract, provided that any non-conformity is insignificant. The intent and the purpose of the building is key. If the building is to house people, that has led to an emphasis on it being fit for occupation, but what amounts to being sufficiently ready for occupation is highly fact-sensitive. And there might be breaches of contract which do not affect the ability of the building to accommodate its occupants and yet can still prevent practical completion, for example if the external paintwork, though fit for purpose as paintwork, is the wrong colour or finish. There are many different reasons why a building might be said not to be practically complete but it is not appropriate even to attempt an exhaustive list.

*Mears Ltd v Costplan Services (South East) Ltd and others*

## 2. Notice of adjudication – how specific must it be?

A painting and decorating contractor obtained an adjudication award for payment but, in enforcement proceedings in the Scottish courts, the award was challenged. It was claimed that the adjudicator had no jurisdiction because the claim lacked sufficient clarity and precision and because the one adjudication had dealt with multiple disputes. So how detailed does a notice of adjudication have to be?

In considering whether the notice of adjudication satisfied the '*threshold of specificity*' so as to refer a dispute to, and confer jurisdiction upon, the adjudicator, the court said the proper test is set out in paragraph 1(3) of Part I of the Scheme, which merely requires the notice to set out '*briefly*' the nature and a '*brief description*' of the dispute. The repeated requirement of brevity merely emphasises that not much is required to meet the threshold. The defender's approach blurred the distinction between the limited (though significant) purpose of the notice of adjudication (to confer jurisdiction on the adjudicator in respect of a pre-existing dispute) and the purpose of the subsequent referral notice (to set out the basis of the referring party's claim). The court also noted that a notice can define the dispute by referring to other documentation and that the notice is a contractual document to which the usual principles of contractual construction apply: '*...the question to be determined in respect of the scope of the dispute is what a reasonable person in the position of the defender, having the background knowledge available to the parties, would have understood the notice of adjudication to mean.*'

Dismissing the multiple disputes challenge, the court said that the courts have taken a firm line against those who seek to avoid their statutory and contractual obligation to comply with an adjudicator's decision by attempting to characterise one dispute with several issues, as '*multiple*' separate disputes. Disputes arising out of commercial contracts almost invariably give rise to more than one issue. To require each issue to be referred to a separate adjudication would render the statutory Scheme unworkable and would be inconsistent with the statutory objective of achieving an expeditious and inexpensive mechanism for resolving construction disputes. A single dispute may have several component parts. The fact that there are multiple elements in a claimant's claim does not necessarily mean that what is referred to adjudication is not a single '*dispute*'. That a '*dispute' may have multiple issues is implicit in paragraph 20(1) of the Scheme, which says that: 'The adjudicator shall decide the matters [plural] in dispute and may make a decision on different aspects of the dispute at different times*'.

*Siteman Painting and Decorating Services Limited v Simply Construct (UK) Ltd* at:

*https://www.scotcourts.gov.uk/docs/default-source/cos-general-docs/pdf-docs-for-opinions/2018scgla64.pdf?sfvrsn=0*

## 3. Court of Appeal puts brakes on adjudication by insolvent companies

Does an adjudicator have jurisdiction to deal with a claim by an insolvent company? If it does, what is the point? And if the adjudication is futile, should the court stop it with an injunction?

In ***Bresco v Lonsdale***, the Court of Appeal ruled that a party in liquidation can pursue its claims in court, arbitration or adjudication, regardless of its liquidation. A claim continues to exist for all purposes and, technically, an adjudicator therefore has jurisdiction to consider the claim. Judgment in favour of a company in insolvent liquidation (and no stay), where there is a cross-claim, will, however, only be granted in an exceptional case. Adjudication of a claim by a contractor in insolvent liquidation, where there is a cross-claim, would, because it is incapable of enforcement, consequently be '*an exercise in futility*'.

The court considered that there is a basic incompatibility between adjudication, a method of obtaining an improved cashflow quickly and cheaply through a rough and ready process, and the insolvency regime, which is an abstract accounting exercise, principally designed to assist the liquidators in recovering assets to pay creditors a dividend. Wider considerations also indicated this incompatibility. A liquidator has limited assets to pursue claims of the insolvent company, which would ordinarily be wasted in making an unenforceable claim. And why should a responding party have to incur the costs of defending an unenforceable adjudication, or, if summary judgment is granted, the costs of bringing its own claim in court to overturn the adjudication result? And if enforcement was permitted, the increase in enforcement applications would place a further strain on the overburdened resources of the Technology and Construction Court. The Court's solution to the incompatibility issue was the grant of an injunction to restrain further continuation of the adjudication.

*Bresco Electrical Services Ltd v Michael J Lonsdale (Electrical) Ltd [2019] EWCA Civ 27*

## 4. Court of Appeal warns against stopping a CVA company from using adjudication

In a separate appeal heard with ***Bresco v Lonsdale***, the Court of Appeal noted that, although each case will turn on its own facts, in considering adjudication enforcement, there are potentially important differences between a company in liquidation and a company in a Company Voluntary Arrangement. A CVA is, or can be, conceptually different. It is designed to try and allow the company to trade its way out of trouble and the quick and cost-neutral mechanism of adjudication may be an extremely useful tool to permit the CVA to work. In those circumstances, courts should be wary of reaching any conclusions which prevent the company from endeavouring to use adjudication to trade out of its difficulties. On one view, that is what adjudication is there for: to provide a quick and cheap method of improving cashflow.

*Cannon Corporate Ltd v Primus Build Ltd at:*

*https://www.bailii.org/ew/cases/EWCA/Civ/2019/27.html*

## 5. New company reporting regulations in force

The Companies (Miscellaneous Reporting) Regulations 2018 are now in force and apply to company reporting on financial years starting on or after 1 January 2019. The first actual reporting under the regulations will, with one exception, therefore start in 2020.

Reporting requirements in respect of pay ratios apply to large UK listed companies with over 250 employees. In addition all large companies are required to report on how their directors take employee and other stakeholder interests into account, and large private companies must report on their corporate governance arrangements.

See:

*https://www.gov.uk/government/news/new-executive-pay-transparency-measures-come-into-force*

and

*https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/755002/The_Companies__Miscellaneous_Reporting__Regulations_2018_QA_-_Publication_Version_2__1_.pdf*

## 6. Retention Bill second reading postponed yet again but public sector Project Bank Account Bill heading for March second reading

The second reading debate of the Construction (Retention Deposit Schemes) Bill introduced by Peter Aldous MP has been postponed again, from 25 January, to 22 March 2019.

In the meantime, the Public Sector Supply Chains (Project Bank Accounts) Bill 2017-19 sponsored by Debbie Abrahams MP, which requires public authorities to pay certain suppliers using project bank accounts, received its first reading on 15 January. Its second reading is scheduled to take place on Friday 1 March 2019.

## 7. And coming later this year – the VAT reverse charge

1 October 2019 will see the introduction of a VAT domestic reverse charge for building and construction services. As the charge will only affect supplies at the standard or reduced rates where payments are required to be reported through the Construction Industry Scheme, supplies between subcontractors and contractors, as defined by CIS, will be subject to the reverse charge unless supplied to a contractor who is an end user.

The domestic reverse charge means that the customer receiving the supply of specified construction services must account for the VAT due rather than the supplier. In turn, the customer deducts the VAT due on the supply as an input, meaning no net tax is payable to HMRC.

Due to the diverse nature of the building and construction sector more detailed guidance is to be published during the run-up to 1 October 2019.

See: *https://www.gov.uk/government/publications/vat-reverse-charge-for-building-and-construction-services-guidance-note*

If you have any questions or require specific advice on the matters covered in this Update, please contact your usual Mayer Brown contact.