JUDGMENT : His Honour Judge Humphrey Lloyd Q.C. 19th September 2001. TCC

Preface :

1. Judgment was to have been given on 17 August 2001, a draft having been circulated earlier. I then acceded to an application by the defendant to postpone doing so until it had had an opportunity of making submissions and tendering evidence in support of an application to vary the proposed text. I therefore adjourned the trial until 19 September. (*The defendant had agreed that judgment should nevertheless then be entered for the claimant for the amount that I proposed to award*.) On 19 September, before the case was called on, the parties reached agreement on all issues of interest and costs which had yet to be decided. Both then submitted that the reasoned judgment as drafted should not be delivered in open court. I was referred to **Prudential Assurance Co Ltd v McBains Cooper** [2000] 1 WLR 2000. I decided that there were grounds of public interest to justify delivering part of the proposed judgment. The following is that part. The remainder of the draft judgment will not now be given and remains confidential and is not to be used or referred to for any purpose (*without the leave of the court*). *(I also heard and determined the application to vary the text in so far as it related to that part*.)

   The claimant, Durabella, was a sub-contractor to the defendant, Jarvis. It claims to recover £65,431.82, being the balance of the price (£70,951.14) of work done by it, less an amount paid on account (£5,519.32), plus interest. These figures are agreed Jarvis contend that the work was defective. The work was the provision of hardwood flooring in 36 flats which Jarvis was constructing for Galliard Homes Ltd (Galliard) at Old Sun Wharf, Narrow Street, Limehouse, London, E14. Jarvis resist payment on the principal ground that the work was not properly carried out. Jarvis counterclaims for losses said to have been incurred by it and for amounts allegedly paid to Galliard. Galliard was dissatisfied with the performance of Jarvis (for a number of reasons, quite apart from problem with the flooring) and terminated its employment. (In evidence Mr Stephen Conway, a director of Galliard, said that Jarvis was late, disorganised and its programming was chaotic.) In proceedings brought by Jarvis (1996 ORB 1073) and during the course of the contract Jarvis had maintained that Durabella's work was not defective. The proceedings were settled by a Tomlin order of 2 February 2001, Jarvis now finds itself in the interesting and potentially difficult position of maintaining that Durabella's work was not acceptable. The terms of the settlement included the following:

   " 1. [Jarvis] accepts the payment of £550,000 (to be made in accordance with paragraph 3 below) in full and final settlement of all its claims arising out of or in connection with the Development including (but not limited to) all of its claims in the Action and all orders for costs in its favour including costs made by the Court of Appeal and House of Lords.

   2. Galliard makes the payment on the basis that:

   a. it is in full and final settlement of all its claim and counterclaims arising out of or in connection with the Development including (but not limited to) all of its claims in the Action and all orders for costs in its favour;

   b. without prejudice to the generality of the preceding paragraph no value is included within the settlement figure for works undertaken in connection with the Development by Durabella Limited the subject matter of Action Number 1998 ORB No 33 in the High Court of Justice, Technology and Construction Court, and Galliard has taken account of its counterclaim of £162,460 in respect of such works in calculating the sum to be paid to [Jarvis] under this Deed.

   [Jarvis] and Galliard will forthwith apply to the Court for payment out of the sum of £225,000 currently standing in Court to [Jarvis'] solicitors with any interest on such amount to he paid to Galliard's solicitors. Galliard will pay the balance of £325,000 to [Jarvis'] solicitors within 14 days of the date of this Deed. "

   Jarvis also rely on its own "pay when paid" clause which depends on the formation of the sub contract. The trial was notable for the efficiency with which it was conducted, as required by the small amounts at stake. The submissions concerning the contractual issues were almost entirely in writing (as were the final submissions) and lost nothing by being in that form. I therefore intend to begin with some contractual issues and then to consider the remaining facts and main issues.

Sub-Contract Issues

2. Mr Adrian Hughes for Jarvis posed the first issue as: *"Did the contract between Jarvis and Durabella incorporate: (a) Durabella standard terms; (b) Jarvis standard terms; (c) DOM/1 terms and conditions in conjunction with the Jarvis standard terms?"*

   The relevance of these questions is that Jarvis wish me rely on the *"pay when pay"* provision in clause 4 of the Jarvis standard terms, on the assumption that it has been paid by Galliard. I was referred to the well-known American and English authorities, which are summarised in, for example, Keating on Building Contracts , 7th ed., at para 12-63, but they do no more than set out the considerations that might apply in deciding what such a provision means. The policy adopted in some American jurisdictions need not necessarily apply here. There is otherwise no (or no recent) relevant authority in this country affecting Jarvis' provision.

3. On 10 August 1995 Durabella submitted an estimate for the initial three show flats. It concluded: "This estimate is subject to Durabella's standard terms and conditions, a copy of which is available on request". Jarvis sent Durabella an order dated 24 August 1995 which stated *"No conditions of your quotation which are additional to, or at variance with, those of this order shall be applicable, except as stated below"*. The order then referred to, and was accompanied by, the Jarvis standard conditions. Clause 4 provides:
   "Our liability for payment to you is limited to such amounts as we ourselves actually receive from the employer in respect of your works under this order".

   Durabella thereafter got on with the work on the initial flats.

4. On 13 December 1995 Jarvis sent Durabella a letter of intent for the remaining 33 flats. This said, amongst other things:
   "... We confirm our intention to enter into a sub-contract order with you for providing labour, materials and plant for carrying out flooring works to 33 units at the above.
   The basis of the conditions of contract will be in accordance with DOM/1 with amendments to incorporate Jarvis standard conditions.
   The 33 units will be carried out as defined in your letter dated 10 August for Tarkett Presealed Maple Country Strip flooring at £39.90 per square metre less 2½% discount…."

   The letter then dealt with contacts for the purposes of survey and measurement and with programming and concluded:
   "Once the quantity has been established and the full requirements known for the 33 units, we will then be a position to firm up and place the sub-contract order."

5. Durabella replied on 14 December 1995:
   "Thank you for your instruction regarding the above contract. The project file has now been entered onto our Customer Auditing Procedure in line with our Quality Assurance Policy for financial and contractual qualification".

   (Another letter to the same effect was sent on 21 December) On the next day Durabella wrote further about Jarvis' programme and methods to which Jarvis replied on 2 January 1996. The next letter from Durabella on 9 January 1996 read as follows:
   "We acknowledge receipt of your letter of intent dated 13 December 1995 which we are pleased to take as acceptance of our estimate reference AA/EME/6478/33 dated 10 August 1995 for works carried out to the end of March 1996 after which the fixed price period expires, and increased costs of 5% will be applicable.

   We have previously written in relation to your indicative programme, on the basis that the periods included are too short, However, events have overtaken us, in that the Tarkett material specified is not available for 6 to 8 weeks in this country. If this is unacceptable we will be pleased to discuss alternative Tarkett materials which are hopefully on a shorter delivery time, if this is an option to yourselves. There may be costs implications though.

   To assist in the administration of this sub-contract, we enclose for your attention and distribution to your site staff:
   1. *Method Statement MS6.*

2. *Method Statement in respect of unloading and distribution of materials.*
3. *Tax Exemption Certificate.*
4. *Insurance Details.*
5. *Safety Policy and COSHH.*

One of our Contracts Managers, Mr Russell Martin, has been assigned to this contract and he will contact you to discuss programming, labour etc. If you have any queries please contact this office quoting reference L769/RM.

We look forward to working with you on this contract and to its successful completion to our mutual benefit."

It therefore treated Jarvis, letter as an "acceptance of our estimate …. for works carried out to the end of March after which the fixed price period expires, and increased costs of 5% will be applicable". The letter then raised points on programming matters. I shall deal later with the Method Statement MS6.

6. Mr Jonathan Ferris submitted that the letter of 9 January was a counter-offer because it sought terms which differed from those in the letter from Jarvis dated 13 December. He referred me to Chitty on Contracts, 23rd ed, para 2-033 which deals with the problem of the "battle of forms". He argued that not only had Durabella fired the last shot but Jarvis' reference to DOM/1 was ineffective since there never was a main contract between Jarvis and Galliard as the Court of Appeal held when refusing Galliard's arbitration application to stay the action brought by Jarvis ([1999 1 All E R (D) 7 1266). (The House of Lords refused a petition to appeal.) He also contended that Jarvis never followed up its "letter of intent" by placing a sub-contract order as contemplated by it on 13 December.

7. I do consider that the terms of the "letter of intent" indicated that Jarvis intended to create a legal relationship with Durabella. It is now well established where a "letter of intent" authorises work, materials or services to be provided pending the conclusion of some further agreement it will, if accepted, constitute a contract (or part of a contract) for what it requires. The "letter of intent" may never be supplanted by a further agreement. It will be the contract far the work etc. Many large projects have been carried out on such a basis. It is equally well established that in a commercial relationship the court will try to establish a contract or contracts since that would be consistent with the parties' presumed expectations. On the other hand a contract cannot exist unless it is clear that, viewed objectively, the parties were in fact agreed on all the matters which they considered necessary and which are necessary to form a contract.

8. In my judgment it is clear that at the time of Jarvis' letter the parties were well on their way to agreeing on all the matters necessary for a contract. The scope of work was established – Tarkett flooring to 33 flats. The rate was agreed - £39.90 per square metre. For the purposes only of expressing the total contract sure it was necessary to survey and measure the flats. The programme had yet to be agreed but it was not considered to be a problem and, indeed, was not a problem. Jarvis' letter was treated by Durabella as having contractual force - see its letters of 14 and 21 December 1995 and 9 January 1996. The first two letters are not simply administrative as there would be no point in them unless an order was being entered in Durabella's books. Even if that conclusion were incorrect the letter of 9 January was clearly an acceptance of Jarvis' letter. It did not constitute a counter-offer as there was nothing in it which was inconsistent with Jarvis' letter. It was not then or subsequently treated by Jarvis as containing anything at variance with Jarvis' requirements. The reference to Durabella's estimate, as such, is insufficient to displace the terms required by Jarvis. There was no reassertion of Durabella's terms. There was indeed no true battle of forms; Jarvis had made its terms clear when contracting for the initial three flats. Durabella's case correctly, in my judgment, presupposes that the Jarvis' letter was an offer. That offer was either accepted by Durabella's letters, in particular its letter of 9 January, or if programming were considered to be vital to a contract (which it normally is but in this instance appears not to have been seen as crucial to the creation a binding agreement), then by its subsequent conduct in carrying out the work in accordance with arrangements agreed with Jarvis. It is ill my judgment clear that Jarvis intended that its formal order was being postponed solely so that it could record the results of the survey and measurement, i.e. the quantity to be paid for as the agreed rate.

9. The contract therefore incorporated Jarvis' conditions of which Durabella had had notice in August 1995, even though they were probably not sent on the second occasion. Durabella did not then write to ask

what they were, presumably because it had them. The contract also incorporated the conditions of DOM/1 in so far as they were not displaced by Jarvis' conditions. DOM/1 is of course a well-known standard form which a person with the standing of Durabella must be taken to know (even if it was not on the file as Mr Martin expected.) It has been drafted on the assumption that there will be a main contract in a JCT form but the absence of such a contract does not in my judgment mean that it ceases to have any effect. It will still function satisfactorily. Similarly the fact that Jarvis and Galliard did not conclude an orthodox main contract does not mean that Durabella was not a sub-contractor. A sub-contract is no more than a contract entered into by a person to enable that person the better to perform its obligations under another contract or arising from a relationship akin to contract. In the Court of Appeal Lindsay J and Schiemann LJ did not consider it necessary or desirable to decide the contractual relationship that had been created. Evans LJ however, whilst loath not to find a contract, said he found it impossible to say a contract came into existence principally because the terms were not certain. It is however clear that Jarvis carried out its work pursuant to some letter of intent or "expressly provisional" contract, as Evans LJ put it.

10 The second issue suggested by Mr Hughes is:

"Has Jarvis been paid by the employer for all or part of the Durabella subcontract flooring works ("the works")?"

For the purposes of this issue it is necessary to look ahead a little. In 1996, as Durabella was about to complete the flooring, it was found that it was rising, The architects, BUJ Architects, on 10 May 1996 wrote to Jarvis:

"We herewith enclose Interim Certificate No 6 in respect of the above. We would draw to your attention that we have deducted £28,400 from the gross valuation based on our estimate that 40% of the Durabella Flooring installed to date is defective and is required to be rectified/replaced."

Jarvis was paid the amount of this certificate and thus received £1,029,752, of which £41,000 was on account of the value of the Durabella work, but it did not pay Durabella. The next month BUJ wrote:

"We herewith enclose our Interim Certificate No 7 dated 21 June 1996. We would inform you that we have deducted the sum of £96,500 (ninety six thousand five hundred pounds) for works not in accordance with the contract. "

Of that amount £50,000 was referable to Durabella's work (70% of £70,997). Both BUJ and Galliard assumed that there was a contract with Jarvis which incorporated the JCT conditions. On 7 June BUJ had issued a notice under clause 27.2.1.2 and on 24 June 1996 Galliard purported to determine the employment of Jarvis under clause 27.2.2. The effects of the decision of the Court of Appeal were that since there was no contract with JCT conditions Galliard was not entitled to determine Jarvis' employment and since there was no contract but for one constituted by Galliard's letter of intent Galliard was entitled to tell Jarvis to stop work at any time on reasonable notice. It was liable to pay Jarvis upon a quantum rneruit, i.e. a reasonable amount for the work that was done.

11. After the decision of the Court of Appeal Jarvis' claim for a quantum rneruit headed for trial. This action had in June 1998 been ordered to be tried at the same time so it had been held up. Since Jarvis contended in the Galliard action that Durabella's work was not defective it did not make Durabella a co-defendant in that action, even on an alternative basis. Galliard paid £225,000 into court on 18 October 2000. Jarvis was advised that it could do better and did not accept the payment. In without prejudice correspondence about the payment Shadbolt & Co, Galliard's solicitors, said that Galliard regarded "the value of the flooring to have been a negative value in the context of the fit-out as a whole". On 8 November Jarvis made a Part 36 offer that it would accept £400,000 for all claims and counterclaims, but excluding costs. Later Jarvis decided to settle. The negotiations were conducted for Jarvis by Mr Richard Ward, a partner of Eversheds. Mr Ward gave evidence. Surprisingly he said that he made no notes or records of any of the discussions or conversations. There was also very little correspondence which might have helped Jarvis or Durabella to throw light on what was included in the settlement. That correspondence was produced after the start of the trial only after I had questioned Mr Hughes whose instructions were that there were no such documents, although correspondence with Durabella's solicitors was at variance with that position. Mr Ward admitted that he had seen Mr Hughes' skeleton argument which had said that there was no

additional documentation. It was plainly wrong and misleading to allow counsel to open the case in that way when there was correspondence relating to the settlement which ought to have been disclosed. This is not only the only feature of the conduct by Eversheds of Jarvis' defence in this action which has given rise to disquiet.

12. Although Jarvis was at risk on costs as it had not accepted the payment into court, it would recover its costs up to that time. In his witness statement he said that, allowing for taxation, Jarvis worked on the basis that the likely recoverable figure would be in excess of £400,000. Mr Ward offered £600,000 in a telephone conversation. He agreed in cross-examination that he required Galliard to say in the settlement that it "had included no value within the settlement for the Durabella works and furthermore Galliard in agreeing the settlement figure had deducted the sum of £162,460" as that was the figure derived from Galliard's Scott Schedule. Galliard came back with £575,000 and, after some faxes, agreement was reached at £550,000. The wording of the settlement was then agreed. The settlement deed had already been drafted by Mr Michael Black QC for Galliard. It followed almost exactly the terms required by Mr Ward as set out in his fax of 23 January 2001 terms which Mr Ward accepted had been "imposed" by him on behalf of Jarvis. The figures were filled in and the deed was executed. It is therefore clear that clause 2.b.i of the settlement singles out Durabella's work and, exceptionally, places a figure on it, solely for Jarvis' purposes, as Mr Ward had to admit.

13. In these circumstances the deed has no evidential value whatsoever as showing whether or not Jarvis received payment for Durabella's work. Clause 2.b.i was devised by Mr Ward with the deliberate intention of misleading readers, namely Durabella, its advisers and the court, as to Galliard's supposed position. Only after he was required to disclose the correspondence and to give evidence was the device exposed.

14. As asserted by Mr Ward, £400,000 of the amount received by Jarvis went towards Jarvis' recoverable costs, leaving it with no more than about £150,000 (in addition to the sum that it had already received) towards Jarvis' entitlement to a quantum meruit. Although a quantum meruit may be assessed by reference to the value placed by the parties on elements of the work, especially if there were rates and prices in waiting, as it were, the final amount is necessarily an overall figure without any build up. So it is impossible for Jarvis to rely on the settlement to show that it has not been paid. I shall in any event deal later with what Jarvis might have received. For purposes of the present issue Jarvis has failed to establish that it had not been paid for the Durabella work.

15. The third issue posed by Mr Hughes was: *"If Jarvis has not been paid, is Durabella precluded from any entitlement it might otherwise have had by the "pay when paid clause" at clause 4 of Jarvis' standard terms?"*

    Mr Hughes submitted that clause 4 should be respected as it protected a contractor caught in a dispute between employer and sub-contractor. He referred to the comment in Keating on Building Contracts, 7th ed. at para 12-63 where the editors say, somewhat delphically, "there is no reason, in principle, why the English courts should not give effect to a properly drafted clause according to its true construction". They then express the opinion that the application of the test of reasonableness as set out in section 3(2)(b) of the Unfair Contract Terms Act (UCTA) might render such a clause unreasonable and ineffective or ineffective in the circumstances.

16. Mr Ferris' attack on the clause focused on its reasonableness in a number of aspects, in particular for the purposes of section 3(2) of UCTA Clause 4 clearly forms part of Jarvis' standard terms. However Durabella was of equal bargaining power - it had devised its own terms. Questions of insurance do not arise so the ambit of such a provision is narrowed. The burden of course lies on Jarvis. Mr Ferris submitted that it was unreasonable not to pay for work that had been done properly. Since Durabella's case on the facts was that the reason why Jarvis had not been paid was its expulsion from the site because of its own default (or was its contribution to the defects) he also maintained that the clause should not apply in such circumstances.

17. In my judgment the latter point is covered both by the common law and by UCTA (see section 3(2)(a)). A contractor cannot rely on a "pay when paid" clause if the reason for non-payment is its own breach of contract or default. It is trite law that one cannot take an advantage from one's breach of contract. So if the

employment of a contractor under a JCT form had been lawfully terminated for default to which a sub-contractor had not contributed then the contractor could not take advantage of the provisions by which the normal contractual code for payment is replaced by the new code under which no further payments may he made until completion. The contractor has either deprived the sub-contractor of the opportunity to complete the sub-contract works, or, if they have been completed, of the opportunity to be paid upon application, statement, or certificate.

18. In addition a provision as such as clause 4 can only be effective so long as the machinery of payment is capable of being operated. It is an implied condition for the operation of such a clause. If the machinery breaks down, eg certificates are not or cannot be issued as they should be, then the contractor, although it may not in any way be responsible, is nevertheless best placed to remedy the situation. If the clause is to be effective then the contractor impliedly undertakes that it will pursue all means available to obtain payment, or it will not be able to rely on the provision to defeat the subcontractor's claim. On the other hand I do not accept the argument that clause 4, by itself, or read in conjunction with the other terms stipulated by Jarvis, including DOM/1, is ineffective unless there is a main contract. The clause merely refers to amounts received from the employer. It does not refer to any contract with the employer nor do I consider that a contractual payment is to be inferred. As happened here payments may be received from an employer before the principal contract is made and at a time when there may not even be a conditional agreement or they may be received for work done outside the scope of a contract, upon an implied promise to pay, or extra-contractually such as an "ex gratia" payment. On the facts of this case Jarvis could not rely on the "pay when paid" clause, first, because once its employment had been terminated because of its supposed default, it lost the right to interim payments if, as was thought, the JCT conditions applied, or, as there was no such contract since it had lost the opportunity for payments on account since its own conduct had brought its employment to an end, and, secondly, and in any event, because it failed to pursue its remedies promptly and effectually.

19. There are two principal reasons for a "pay when paid" or "pay if paid" clause. First, all work has to be financed until payment is received, The clause extends the period for financing until payment is received and relieves the contractor of an obligation to do so until payment is received. (Depending on the period for payment the contractor may of course make something out of the money until it is paid over.) Secondly, the risk of insolvency is shared proportionately.

20. Mr Ferris suggested that s113 HGCRA 1996 was relevant to the consideration of the reasonableness of clause. There are in my view difficulties in having regard to this section. First, it was not enacted when the sub-contract was made. Secondly, it cannot reliably be used as a contemporary (or retroactive) indicator of industry practice, as I and others have said elsewhere (see for example paragraphs 24-31 of the judgment of His Honour Judge Thornton QC in **Palmers Ltd v ABB Power Construction Ltd** [1999] BLR 426 pages 433-434). In **ABB Power v Norwest Holst Construction**, 1 August 2000, I considered that the Act had been carefully drawn up with great care in selecting the construction operations that were to be exempt and in defining the circumstances where they might he found. Certain sectors of the construction industry were found to be already so well organised that no regulation of any of their contracts or sub-contracts (at whatever level or tier) was needed. Thus the immunity given to work in, for example, the water, oil and gas industries signified the absence of malaises which had been found to bedevil others, such as the prevalence of disputes and the presence of "pay when paid" clauses, or for the fact that the reforms required by the Act were not needed or had been carried out. In these circumstances it is difficult to conclude that, but for section 113(1), such a clause was perceived throughout the construction industry as unreasonable in itself. If it were then Parliament would have prohibited it throughout the industry. The well-regulated parts would not have minded as it would not affect them. The absence of such an industry-wide prohibition strongly suggests that in some areas a "pay when paid" was and is not only not unreasonable but a fair apportionment of some of the common risks of contracting.

21. In addition S113(1) of HGCRA only makes a "pay when pay" clause ineffective as regards financing the work. S113 (1) does not affect its application in the event of insolvency so one of the primary purposes is recognised as not unreasonable, is that the contractor is not the guarantor of the employer's solvency and the risk of being unable to recover payment is one that may legitimately be shared. By this criterion a "pay

when paid" clause can only be unreasonable in postponing payment until the contractor is paid on account, as it is lawful to require the payee to accept the risk that no payment may ever be made where the employer is insolvent. Where the employer is not insolvent then, as I have said, the contractor is obliged to pursue all available remedies if the clause is to remain effective. Furthermore, section 113(1) does not affect payment on conditional certificates. As provided by ss109 and 110 (and 113(6)) of HGCRA, payment periods can be agreed which have the effect of ensuring that, where the main contract payment system is operating properly, payments to a sub contractor need not be made until after the time when payment should have been received. The risk of having to finance work before payment is received is either averted or at the least minimised. The parties' freedom to make such arrangements is legitimate and not unreasonable. Accordingly I do not consider that one can conclude that clause 4, in so far as it is conditional on payment being received by Jarvis from another, is unreasonable in itself although it may be in the circumstances.

[Passages not delivered]

22. In addition in my judgment Jarvis has not established that it suffered any loss. In the Galliard litigation it was agreed that the value of Jarvis' work upon a quantum meruit was £1,293,640, of which about £68,000 was referable to Durabella. This is greater than the amount of the claim in this action. Jarvis' claim was assessed by Mr Walmsley to be about £1.6m, so the difference concerned items in the claim that were subject to further agreement between Mr Walmsley and Mr Dungar (Galliard's quantity surveyor). Jarvis was paid £550,000 as a result of the settlement and thus received £1,579,752 (including amounts paid up to Interim Certificate). That includes Jarvis' costs, but I am not inclined to accept that the figure for costs is £400,000. That estimate comes from Mr Ward who misled Durabella and the court about the settlement. His evidence is not reliable. Jarvis declined Galliard's payment into court of £225,000 which would have given them £1,254,752 plus costs. There was no evidence why Jarvis would have accepted less by the date of the settlement. Accordingly, as Mr Ferris submitted, the settlement of £550,000 must have represented a better deal for Jarvis than the payment into court so the figure of £400,000 for costs could not be right. On this basis there would have been no reason to abate the claim.

23. It also follows that Jarvis has failed to establish that it has not been paid the full value of Durabella's work, ie £70,951.15. This is only a few thousand pounds more than the amount included in the assessment of Jarvis' quantum meruit. Since, as Mr Ferris submitted, Jarvis had every opportunity to adduce candid and honest evidence of what it had and had not received but did not do so (as it relied on Mr Ward) I am unable to find, for the purposes of Jarvis' "pay when paid" case, that it did not receive what was and is due to Durabella. Indeed Jarvis must have known that if the matter care to trial it could not rely on the clause - hence Mr Ward's attempted deception.

[Remainder not delivered]

Jonathan Ferris appeared for the claimant, instructed by Michael Corm Goldsobel
Adrian Hughes appeared for the defendant, instructed by Eversheds.