

Construction Law Update

Hybrid Construction Contracts: Payment Notice Requirements

In the recent case of *C Spencer Limited v MW High Tech Projects UK Limited*, the court considered a Part 8 ‘smash and grab’ claim for around £2 million, brought by C Spencer Limited (“**CSL**”) against MW High Tech Projects UK Limited (“**MW**”). The key question to address was whether, in the case of a hybrid contract (one which provides for both ‘construction operations’ and ‘non-construction operations’ within the meaning of Housing Grants, Construction and Regeneration Act 1996 (as amended) (“**HGCRA**”), a valid payment notice for the purpose of s111 HGCRA had to identify separately the sum due in respect of ‘construction operations’ and the basis upon which it was calculated, and the sum due in respect of ‘non-construction operations’.

Background

The parties entered into a hybrid contract in November 2015 which provided for periodic interim payments (the “**Contract**”). In February 2019, CSL issued application for payment 32; separating the sums it considered due for ‘construction operations’, and the sums it considered due for ‘non-construction operations’ (the “**Payment Application**”). In response, MW submitted a payment notice, which valued the application at a negative figure (the “**Payment Notice**”). No pay less notice was issued. MW’s Payment Notice contained a detailed breakdown of the works and variations but failed to separate the sums into those due for ‘construction operations’ and those due for ‘non-construction operations’. As a result, CSL claimed that the Payment Notice was invalid and attempted to recover the sums claimed in its Payment Application on a ‘smash and grab’ basis.

The Parties’ Positions

CSL argued that, because the statutory payment regime in HGCRA (the “**Scheme**”) was of mandatory application to the ‘construction operations’ element of the works, but had no application to the ‘non-

construction operations’ element of the works, in order for the Scheme to operate successfully it was necessary to be able to identify the sums due in relation to the ‘construction operations’ alone. Not separating the sums due, CSL argued, could prevent enforcement of the Scheme. In order to prevent this consequence, the Contract had to be construed in a way which made it compliant with HGCRA, namely, as requiring payment notices to separate the sums due. MW had not done so and as a result, the Payment Notice did not comply with HGCRA and was invalid.

MW argued that the payment provisions of the Contract, which were compliant with HGCRA, did not require the sums to be separated. The Payment Notice complied with the payment provisions and was therefore valid.

Considerations of the TCC

Key points considered by the court were the purpose of the Scheme (to ensure cash flow) and the effect of s104(5) HGCRA (which limits the application of the Scheme to the ‘construction operations’ in a contract). It was held that, whilst the parties could not contract out of the Scheme in relation to ‘construction operations’, there was nothing stopping parties agreeing that ‘non-construction operations’ should be subject to the same provisions. This was the case in the Contract, the payment regime of which essentially mirrored the Scheme.

Due to the Contract being compliant with the Scheme, the court distinguished previous case law in which the statutory adjudication provisions and payment provisions of HGCRA respectively had been implied into hybrid contracts in relation to the ‘construction operations’ only, whilst the non-compliant contractual provisions had remained applicable to the ‘non-construction operations’.

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The TCC's Decision

Where the payment regime of a hybrid contract mirrors that of the Scheme, a payment notice is not required to separately state the sums due for 'construction operations' to be a valid notice for the purposes of HGCR.

The reasons given by the court are as follows:

- although the Scheme requires a payment notice to state the sum considered due and the basis upon which it is calculated in relation to 'construction operations', it does not expressly limit the sums considered due to those in relation to 'construction operations';
- where the contractual provisions mirror those of the Scheme, a single payment notice may be valid under both the Scheme and Contract;
- in these circumstances, there would be no difficulty in enforcing the Scheme in relation to the 'construction operations' element of the Contract (as CSL had argued), because the same provisions applied to the 'non-construction operations'; and
- the cashflow objective of the Scheme was not undermined.

MW's Payment Notice was therefore deemed valid and the Part 8 proceedings were disposed of.

Had the Payment Notice been deemed invalid, the parties had submitted alternative arguments in relation to estoppel, the suitability of Part 8 proceedings to this case and CSL's entitlement to rely on the sum claimed in its Payment Application. These points were also considered by the court which provided obiter comments on the same.

Analysis

The court's judgment in this case will have no doubt been a relief to MW. However, paying parties in hybrid contracts should not rely on this case as an excuse to become careless. As with most cases, this decision was fact specific. On top of the fact that the relevant provisions of the Contract mirrored those of the

Scheme, one of the reasons that MW's Payment Notice was deemed valid was that there were no deficiencies identified in its global assessment of the works; if the validity of the global assessment had come into question, the court commented that MW may have '*struggled to rely on its [Payment Notice] for the purpose of HGCR*'.

From a practical point of view therefore, the safest option for paying parties in hybrid contracts would still appear to be to separate the sums it considers due in its payment notices.

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