

Construction Law Update

Hybrid Construction Contracts: Guidance from the Court of Appeal

In the recent case of *C Spencer Limited v MW High Tech Projects UK Limited*, the Court of Appeal considered whether, in the case of a hybrid contract (one which provides for both “construction operations” and “non-construction operations” within the meaning of the Housing Grants, Construction and Regeneration Act 1996 (as amended) (“**HGCRA**”)), a valid payment notice must separately identify the sum due in respect of the “construction operations” element of the works.

Background

In November 2015, C Spencer Limited (“**CSL**”) was engaged by MW High Tech Projects UK Limited (“**MW**”) under a hybrid sub-contract which provided for periodic interim payments. Primary elements of the sub-contract works were construction operations within the meaning of s105(1) of HGCRA; however, the sub-contract works also included non-construction operations. In 2018, a dispute arose in respect of interim payment application 31; neither CSL’s application for payment nor MW’s payment notice separately identified the sums due in respect of construction operations from the sums due in respect of non-construction operations.

CSL gave notice of its intention to refer the dispute to adjudication but MW raised a jurisdictional challenge on the basis that the adjudicator was only able to deal with disputes in respect of construction operations and the dispute, as framed by CSL, failed to distinguish between construction operations and non-construction operations. CSL subsequently withdrew its adjudication claim.

In February 2019, CSL issued interim payment application 32 which distinguished the sums due in respect of construction operations and non-construction operations. In response, MW submitted a payment notice which valued the application at a negative figure (the “**Payment Notice**”). The Payment Notice did not allocate any sums by reference to construction operations only.

The TCC’s decision

CSL commenced Part 8 proceedings seeking payment on the basis that MW’s Payment Notice was invalid due to no sum being allocated to construction operations only. MW argued that the payment provisions of the sub-contract did not require the sums to be separated and therefore the Payment Notice was valid.

The TCC held that where a hybrid contract contained a payment scheme that was compliant with (or mirrored) the relevant provisions of the HGCRA for both construction and non-construction operations, a payment notice that did not separately identify the sums due in respect of construction operations was capable of constituting a valid notice under sections 110A and 111 of the HGCRA.

The Payment Notice submitted by MW was therefore valid and CSL’s Part 8 claim was dismissed. Recognising the wider significance of the points raised, the TCC nevertheless gave permission for CSL to appeal against the court’s ruling.

The central issue on appeal

The main issue for consideration by the Court of Appeal concerned statutory and contractual interpretation.

CSL argued that the words in s104(5) HGCRA (“*only so far as it relates to construction operations*”) had to be read into every section of the HGCRA concerned with payment. Consequently, in the context of a hybrid contract, where a payment notice fails to specify (within the overall sum notified) the amount that relates to construction operations only, such payment notice would be non-compliant with the HGCRA.

MW submitted that reading in the additional words was unnecessary and would cause confusion, complexity, and additional cost.

The Court of Appeal’s decision

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The Court of Appeal affirmed the TCC's decision for the following reasons:

- The HGCRA does not require payment terms in a hybrid contract to provide for the separate notification and breakdown of sums due in respect of construction operations only.
- The payment provisions in the sub-contract complied with the mandatory requirements of the HGCRA. There was no requirement on either party to notify and break down sums due in respect of construction operations only in their interim applications, payment notices or pay less notices.
- The HGCRA can be construed perfectly well without reading in any words at all and, as such, it was neither necessary nor appropriate to read in the words from s104(5) ("*only so far as it relates to construction operations*") into later sections of the HGCRA concerning payment.
- Parties are free to extend the payment provisions deriving from s109 – 111 of the HGCRA to cover both construction and non-construction operations.
- The adjudication provisions in the sub-contract had been narrowed so that they only related to referrals in respect of construction operations. A similar limitation/qualification could have easily been applied to the payment provisions of the sub-contract, but ultimately was not.
- Neither the payer nor the payee wants to be in a position where two separate payment processes, with different procedural requirements, are live. Certainty and transparency are upheld if the stage payment is a single sum based on a monthly valuation or the achievement of a particular milestone.

Both the TCC and Court of Appeal concurred that, in the case where separate payment schemes applied, it would be necessary to distinguish construction operations from non-construction operations in respect of each application and payment notice.

However, in this case, a single, compliant payment regime had been agreed by the parties.

Analysis

This case confirms that where a hybrid contract contains a HGCRA-compliant payment scheme applying to both construction and non-construction operations, a payment notice is not required to separately identify sums due in respect of the construction operation element.

However, whether a payment application or payment notice needs to separately identify the sums due in respect of the construction operations depends largely upon the terms of the relevant contract. Plainly, if a contract provides for different payment schemes in respect of construction and non-construction operations or if the payment terms are not compliant with the HGCRA, separate identification of the sums due in respect of the construction operations element is required.

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