**Dual payment regime held to apply to a “hybrid” contract for works subject to the Construction Act and other works which are excluded from the Act.**

In Severfield (UK) Limited v Duro Felguera UK Limited the TCC considered the applicable payment regime under a “hybrid contract” and held that if such a contract does not comply with the Act it will be “a recipe for confusion”.

**Housing, Grants, Construction and Regeneration Act 1996**

The *Housing, Grants, Construction and Regeneration Act 1996*, as amended (“the Act”), applies to “construction operations”. The Act defines construction operations by listing a wide range of matters which constitute construction operations (s105(1)) and excluding some specific works from construction operations (s105(2)) (“excluded operations”). The excluded operations include, amongst other things, “assembly, installation or demolition of plant, machinery…on a site where the primary activity is (i) nuclear processing, power generation” (s105(2)(c)).

The Act provides that if a contract relates to construction operations and other matters (“a hybrid contract”), the Act applies only so far as the contract relates to construction operations (s104(5)). However, before this case, the application of the Act to the payment provisions in a hybrid contract had not been considered by the courts.

**Background**

In 2013 Duro Felguera UK Limited (“Duro”) engaged Severfield (UK) Limited (“Severfield”) to carry out the design, supply and erection of steel structures at two power stations. Severfield’s scope of works included:

- some “construction operations” as defined under which were subject to the Act; and
- matters which were excluded operations under section 105(2)(c) of the Act.
The contract between Duro and Severfield ("the Contract") was therefore a ‘hybrid contract’.

The Contract between Duro and Severfield did not contain all provisions required if the Act applies. For example:

- the payment provisions did not require payment notices and pay less notices to be issued by the parties as provided under the Act; and
- the Contract did not entitle all disputes to be referred to adjudication.

If a contract for construction operations does not comply with the Act, provisions will be implied into the contract under the Act and the Scheme for Construction Contracts. In December 2014 Severfield made Interim Application 15, for £3.7m. Interim Application 15 did not distinguish between construction operations and excluded operations. Duro did not respond to Interim Application 15 by serving a valid payment notice or a valid payless notice as would be required if the Act applied.

Severfield argued that under the Act the sum notified in Interim Application 15 was due and therefore submitted a notice of adjudication. Severfield claimed £2.4m on the basis that this reflected payments arising out of construction operations which were subject to the Act (i.e. Severfield considered that other sums claimed in Interim Application 15 were excluded operations and not subject to the Act).

Duro argued that the adjudicator did not have jurisdiction because much or at least part of the claim related to excluded operations and the Contract did not otherwise entitle disputes to be referred to adjudication. The adjudicator disagreed with Duro and awarded Severfield the full sum claimed. As Duro did not comply with the adjudicator’s decision, Severfield applied for summary judgment. Stuart-Smith J, in the TCC, refused the application on the grounds that it was arguable that the adjudicator had decided various aspects of the claim which related to excluded operations under the Act, and had therefore not had the jurisdiction.

On 24 July 2015 Severfield submitted a revised claim for payment which, it claimed, took into account Duro’s concerns regarding excluded operations. The revised claim totalled £1.4m. Duro did not accept the revised claim and Severfield issued proceedings for £1.4m and applied for summary judgment. Severfield argued that the £1.4m was due under the Act as it related to
construction operations sought in Interim Application 15 for which, pursuant to the Act, Duro failed to issue either a payment notice or a pay less notice.

**Dual Payment Regime**

Severfield argued that the payment provisions of the Act applied to all of the works in a hybrid contract, regardless of whether or not they related to construction operations of excluded operations.

Coulson J found that this argument was contradictory to s104(5) of the Act, which contemplated a hybrid contract, and expressly provided that the provisions apply “only so far as” they relate to construction operations. Coulson J referred to the two most recent cases concerning hybrid contracts; North Midland Construction plc v AE&E Lentjes UK Ltd and Cleveland Bridge (UK) Ltd v Whessoe-Volker Stevin Joint Venture. While neither of these cases dealt with the appropriate payment regime in a hybrid contract, the Cleveland Bridge case in particular considered s104(5) and suggested that both the adjudication and the payment provisions of the Act would only apply to a contract insofar as it relates to construction operations.

The court found that in a hybrid contract, which does not include Act compliant payment provisions, there are two different payment regimes: 1) the provisions implied under the Act will apply to construction operations and 2) the contractual provisions will apply to works which are not construction operations. Coulson J acknowledged that this was “uncommercial, unsatisfactory and a recipe for confusion”. However, it was the inevitable result of Parliament’s express desire to exclude certain industries from the Act.

**Payment Notices**

Interestingly, Coulson J also considered very recent case law regarding payment notices under the Act, in which “because of the potentially draconian consequences, the TCC has made it plain that the contractor’s original payment notice, from which its entitlement springs, must be clear and unambiguous.”

Coulson J found that Severfield’s Payment Application 15 was not a payment notice in respect of the claim for £1.4 million for construction operations “because the basis for the calculation of that figure, let alone the figure itself, is nowhere explained or set out in interim payment application 15”. Because

“**It is key that the contractual payment provisions under any hybrid contract comply with the Act, perhaps even more so than with contracts solely for construction operations.**”
the contract was a hybrid contract, "it was imperative" that Severfield "spell out" the fact that Application 15 was a payment notice.

If Severfield wanted to take advantage of its rights under the Act, "it had to do so in an open way", including spelling out in Payment Application 15 "how the claim was split and why it was that, in respect of the claim for construction operations, a very truncated timetable applied".

Severfield was not therefore entitled to summary judgment and the £1.4m now claimed was not the sum said to be due under interim application 15 notified in December 2014.

Implications

The case demonstrates the practical difficulties caused by s104(5) and s105 of the Act. If you are entering into a hybrid contract which does not contain Act compliant payment provisions, a dual payment regime will apply. As commented by Coulson J this is a "recipe for confusion" and something which you would want to avoid. It is therefore key that the contractual payment provisions under any hybrid contract comply with the Act, perhaps even more so than with contracts solely for construction operations.

The case also underlines the importance of ensuring that payment notices are clear and unambiguous. A recent line of case law has made it clear that interim payment applications and payment notices must be set out with clarity to have the benefit of the provisions of the Act and must comply with the requirements of the Act and the contract in substance form and content.

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