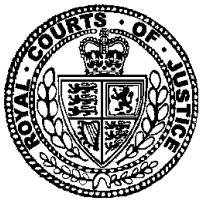

Neutral Citation Number: [2020] EWCA Civ 331

Case No: A1/2019/2597

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
TECHNOLOGY AND CONSTRUCTION COURT (QBD)
MRS JUSTICE O'FARRELL DBE
[2019] EWHC 2547 (TCC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 06/03/2020

Before:

SENIOR PRESIDENT OF TRIBUNALS
LORD JUSTICE COULSON
and
LORD JUSTICE BAKER

- -

Between:

C SPENCER LIMITED	**Appellant**
- and -	
M W HIGH TECH PROJECTS UK LIMITED	**Respondent**

- -
- -

Alexander Nissen QC and Matthew Finn (instructed by **Gosschalks Solicitors**) for the Appellant
Simon Hargreaves QC and Tom Owen (instructed by **Clyde & Co LLP**) for the Respondent

Hearing date: 22nd January 2020

- -

Approved Judgment

LORD JUSTICE COULSON:

1. INTRODUCTION

1. The twin purposes of the Housing Grants, Construction and Regeneration Act 1996, as amended by the Local Democracy, Economic Development and Construction Act 2009 (together referred to as "The Act") was to improve cash flow in the construction industry, and to streamline its dispute resolution process. The former aim was achieved through mandatory provisions relating to interim payments, payment notices and the like, and the latter through a new, compulsory scheme of construction adjudication. The Act has been, on any view, a considerable success.

2. Unfortunately, the Act is not as comprehensive as it might have been. It was suggested during the Parliamentary debates that the then Government was (in the words of Lord Howie of Troon)[1] "got at by some big, powerful, important interests in what are called the process industries. They yielded to those pressures and in so doing lost sight of the aim of the Bill." Whatever the reason for it, many contracts for works which, on any sensible definition, are construction operations, were excluded from the ambit of the Act. To make matters more complicated, the Act recognised that this might create what have subsequently been called hybrid contracts, that is to say contracts providing both for construction operations (which were therefore expressly covered by the Act) and for operations which were expressly said not to be construction operations (and excluded from the Act). In the last 20 years, much too much time and judicial resource has been spent grappling with the problems created by such hybrid contracts, of which this appeal is but one example. But until the Act is amended to do away with these unnecessary distinctions, the courts have to do their best to resolve the resulting, self-inflicted problems.

3. Although this case is, in many ways, a typical example of the genre, it raises a point which has not arisen for decision before. The issue is whether, in the case of a hybrid contract (which therefore provides for the execution of both construction operations within the Act and construction operations outside the Act), a valid payment notice is required to identify *separately* the sum due in respect of construction operations only, along with the basis on which that sum has been calculated. O'Farrell J ("the judge") answered that question in the negative, but she recognised the wider significance of the points and gave the appellant ("CSL") permission to appeal against her ruling.

4. Although the underlying issue might appear somewhat dry, the wider importance of the point was stressed by both leading counsel. On behalf of the Court, I should express at the outset our gratitude to them, and those behind them, for the excellence of their written and oral advocacy.

2. THE FACTUAL BACKGROUND

5. By a contract dated 20 November 2015 the respondents ("MW") were engaged as the main contractor to design and construct a power plant capable of processing refuse-derived fuel produced by commercial and industrial waste and municipal solid waste. By a sub-contract dated 20 November 2015 ("the sub-contract"), CSL was engaged

[1] During the debate on Report in the House of Lords on 22 April 1996, Hansard, 22 April 1996, column 907.

by MW to design and construct the civil, structural and architectural works for completion of the facility. The sub-contract price was £35,650,398.

6. The principal elements of the sub-contract works were construction operations, within the definition of s.105(1) of the Act. But the works also included the assembly of plant, and erection of steelwork to provide support or access to plant and machinery. Such operations are expressly said not to be construction operations and are therefore excluded from the Act pursuant to s.105(2)(c). It is therefore convenient to call them 'non-construction operations' (despite the nature of the work involved). This was thus a hybrid contract.

7. The sub-contract made provision for periodic interim payments, as envisaged by the Act. Those payments were in a form typical of the process industry, namely milestone payments. Those payments did not require a detailed valuation mechanism to arrive at the amount due at each milestone: the amount of each such payment was set out in the sub-contract to reflect the completion of a particular stage or element of the works. Until almost the end of the work on site, the parties operated the payment provisions of the sub-contract without any regard to the definition of construction operations in s.105 of the Act, or any perceived need to identify separate sums for construction and non-construction operations.

8. There was a good reason for that. The sub-contract contained a series of detailed provisions relating to payment. They are set out extensively at [24] of the judge's judgment ([2019] EWHC 2547 (TCC)) and are not repeated here. On their face, those payment provisions reflected the mandatory requirements of the Act. The judge summarised the contractual regime at [25] as follows:

> "25. Thus, the contractual regime for interim payments under the Subcontract is as follows. CSL is entitled to make an application for an interim or instalment payment on a monthly basis upon completion of each milestone. Each application submitted by CSL must set out CSL's assessment of the amount due in respect of completed milestones and any other amounts to which CSL considers itself to be entitled, together with the basis of calculation of the sum claimed and supporting documentation, less sums previously certified. Each instalment payment becomes due sixteen days after the date of CSL's application ("the Payment Due Date"). The contract manager issues a certificate sixteen days after the application, setting out his response to the application, including the basis on which the certified sum has been calculated. MW is obliged to pay the sum due nineteen days after the Payment Due Date ("the Final Date for Payment"). If MW intends to pay less than the sum due, it must issue a pay less notice no later than one day before the Final Date for Payment. Subject to any pay less notice, the sum due is (a) the amount certified for payment in the contract manager's certificate or, in the absence of such certificate, (b) the amount assessed by CSL as due in its application."

I adopt that summary, which was not disputed by either party on appeal.

9. In 2018, a dispute arose between the parties in respect of interim payment application 31. Neither the application for payment submitted by CSL, nor the payment notice issued by MW, separated out the sums due in respect of construction operations from the sums due in respect of non-construction operations. As had been their practice,

both sides had identified a single figure in their application/notice. There was, however, a significant difference between the two sides' respective figures.

10. In July 2018, CSL gave notice of their intention to refer to adjudication the dispute that had arisen as to the sum due pursuant to application 31. At that point, MW raised a jurisdictional challenge in respect of the proposed adjudication, pointing out that the adjudicator could only deal with disputes in respect of construction operations and not disputes in respect of non-construction operations. MW said that, in circumstances where the dispute framed by CSL in their adjudication notice failed to distinguish between the two, the adjudicator did not have the necessary jurisdiction to decide the dispute. In the face of that challenge, CSL withdraw its adjudication claim.

11. In my view, MW's challenge was in accordance with the terms of the sub-contract. Clause 44.1 of the sub-contract, which set out the provisions in respect of adjudication, made plain that either party's right to refer a dispute to adjudication applied "only to the extent (if any) required by the Act". In other words, if the dispute was in respect of non-construction operations, the Act did not require a reference to adjudication, so that (absent express consent) any adjudicator appointed to deal with disputes about non-construction operations would have had no jurisdiction. In addition, the challenge was in accordance with the authorities: MW's underlying contention that, in the case of a hybrid contract, it was for the claiming party to demonstrate that any reference to adjudication was limited to construction operations, was based foursquare on the judgments of Ramsey J in *Cleveland Bridge (UK) Limited v Whessoe-Volker Stevin Joint* [2010] EWHC 1076 (TCC), [2010] BLR415, and of Stuart-Smith J in the first round of *Severfield (UK) Ltd v Duro Felguera UK Limited* [2015] EWHC 2975 (TCC).

12. On 4 February 2019, CSL issued its application for interim payment 32 in the sum of £3,353,219.22 plus VAT. The covering letter explained that, because MW had drawn the distinction between construction and non-construction operations, CSL were now making that distinction themselves in their own application. Accordingly, the application for payment specified the amount of £2,683,617.09 plus VAT as being the sum allocated by CSL to construction operations. The breakdown that was attached explained how this figure, and the larger figure of £3.3 odd million for the works as a whole, had been calculated.

13. On 19 February 2019, MW served its payment notice 35. It referred to CSL's application for payment, and then went on to give notice that, on MW's case, CSL owed MW £6,818,521.70 excluding VAT. The attached spreadsheet set out the basis for that negative valuation. It was principally made up of various claims made by MW against CSL, including significant claims for delay.

14. In keeping with all previous notices, the breakdown of MW's payment notice 35 did not allocate any sums by reference to construction operations only. MW did not address the issue raised by CSL in their covering letter of 4 February as to the appropriateness of such an allocation.

15. On 14 March 2019, CSL's solicitors wrote to MW claiming the sum due for construction operations as set out in interim payment application 32, namely £2,683,617.09 plus VAT. They said that this sum was due because there had been no valid payment notice or payless notice from MW. It was, and remains, central to

CSL's case that MW's payment notice 35 (paragraph 13 above) was not a valid payment notice, because it did not allocate a sum for construction operations only. That point was challenged by MW's solicitors in a letter dated 19 March 2019. Subsequently, CSL commenced Part 8 proceedings seeking payment of the £2,683,617.09 plus VAT, again on the basis that MW's payment notice 35 was invalid because of the absence of any sum allocated to construction operations only. The Part 8 claim was disputed by MW and resolved by the judge in MW's favour. I refer to her judgment in more detail in Section 4 below.

3. THE LAW

3.1 The Act

16. The provisions of the Act relevant to this appeal are set out below.

17. Section 104 defines a construction contract as an agreement for the carrying out of, or the arranging for the carrying out of, construction operations. Section 104(5) provides:

> "(5) Where an agreement relates to construction operations and other matters, this Part applies to it only so far as it relates to construction operations."

18. Section 105 sets out what are construction operations and what are not. It is worth setting out Sections (1) and (2) in full, if only to demonstrate the complexities of distinguishing between construction and non-construction operations:

> "105 Meaning of "construction operations".
>
> (1) In this Part "construction operations" means, subject as follows, operations of any of the following descriptions -
>
> (a) construction, alteration, repair, maintenance, extension, demolition or dismantling of buildings, or structures forming, or to form, part of the land (whether permanent or not);
>
> (b) construction, alteration, repair, maintenance, extension, demolition or dismantling of any works forming, or to form, part of the land, including (without prejudice to the foregoing) walls, roadworks, power-lines, **[**electronic communications apparatus**]**, aircraft runways, docks and harbours, railways, inland waterways, pipe-lines, reservoirs, water-mains, wells, sewers, industrial plant and installations for purposes of land drainage, coast protection or defence;
>
> (c) installation in any building or structure of fittings forming part of the land, including (without prejudice to the foregoing) systems of heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection, or security or communications systems;

(d) external or internal cleaning of buildings and structures, so far as carried out in the course of their construction, alteration, repair, extension or restoration;

(e) operations which form an integral part of, or are preparatory to, or are for rendering complete, such operations as are previously described in this subsection, including site clearance, earth-moving, excavation, tunnelling and boring, laying of foundations, erection, maintenance or dismantling of scaffolding, site restoration, landscaping and the provision of roadways and other access works;

(f) painting or decorating the internal or external surfaces of any building or structure.

(2) The following operations are not construction operations within the meaning of this Part -

(a) drilling for, or extraction of, oil or natural gas;

(b) extraction (whether by underground or surface working) of minerals; tunnelling or boring, or construction of underground works, for this purpose;

(c) assembly, installation or demolition of plant or machinery, or erection or demolition of steelwork for the purposes of supporting or providing access to plant or machinery, on a site where the primary activity is -

(i) nuclear processing, power generation, or water or effluent treatment, or

(ii) the production, transmission, processing or bulk storage (other than warehousing) of chemicals, pharmaceuticals, oil, gas, steel or food and drink;

(d) manufacture or delivery to site of -

(i) building or engineering components or equipment,

(ii) materials, plant or machinery, or

(iii) components for systems of heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection, or for security or communications systems, except under a contract which also provides for their installation;

(e) The making, installation and repair of artistic works, being sculptures, murals and other works which are wholly artistic in nature.

(3) The Secretary of State may by order add to, amend or repeal any of the provisions of subsection (1) or (2) as to the operations and work to be treated as construction operations for the purposes of this Part.

(4) No such order shall be made unless a draft of it has been laid before and approved by a resolution of each House of Parliament."

19. Section 108 entitles a party to a construction contract to refer a dispute arising under the contract to adjudication.

20. Sections 109, 110, 110A, 110B and 111 all come under the heading of 'Payment'. S.109 enshrines the entitlement to payment by instalments, stage payments or other periodic payments for the work. S.110 provides for dates for payment of the instalments, stage payments or other periodic payments for the work. And ss.110A and 110B contain detailed machinery for the provision of payment notices and payees' notices in default of a payer's notice. Each of these sections contains an express provision that, if the sub-contract does not contain provisions of the kind referred to in the individual sections, then the relevant provisions of the Scheme for Construction Contracts will apply instead. In other words, if the contract does not comply with the Act then, to the extent that it is necessary, the contractual terms will be amended by reference to the terms set out in the Scheme.

21. I take s.110A as an example of these provisions in terms of its style and form:

"110A Payment notices: contractual requirements

(1) A construction contract shall, in relation to every payment provided for by the contract -

(a) require the payer or a specified person to give a notice complying with subsection (2) to the payee not later than five days after the payment due date, or

(b) require the payee to give a notice complying with subsection (3) to the payer or a specified person not later than five days after the payment due date.

(2) A notice complies with this subsection if it specifies -

(a) in a case where the notice is given by the payer -

(i) the sum that the payer considers to be or to have been due at the payment due date in respect of the payment, and

(ii) the basis on which that sum is calculated;

(b) in a case where the notice is given by a specified person -

(i) the sum that the payer or the specified person considers to be or to have been due at the payment due date in respect of the payment, and

(ii) the basis on which that sum is calculated.

(3) A notice complies with this subsection if it specifies -

(a) the sum that the payee considers to be or to have been due at the payment due date in respect of the payment, and

(b) the basis on which that sum is calculated.

(4) For the purposes of this section, it is immaterial that the sum referred to in subsection (2)(a) or (b) or (3)(a) may be zero.

(5) If or to the extent that a contract does not comply with subsection (1), the relevant provisions of the Scheme for Construction Contracts apply.

(6) In this and the following sections, in relation to any payment provided for by a construction contract -

"payee" means the person to whom the payment is due;
"payer" means the person from whom the payment is due;
"payment due date" means the date provided for by the contract as the date on which the payment is due;
"specified person" means a person specified in or determined in accordance with the provisions of the contract."

22. The first part of Section 111 might be thought of as the logical consequence of the preceding sections, because it contains an express provision that a payer must pay the "notified sum" in sub-sections (1) and (2):

"111 Requirement to pay notified sum.

(1) Subject as follows, where a payment is provided for by a construction contract, the payer must pay the notified sum (to the extent not already paid) on or before the final date for payment.

(2) For the purposes of this section, the "notified sum" in relation to any payment provided for by a construction contract means -

(a) in a case where a notice complying with section 110A(2) has been given pursuant to and in accordance with a requirement of the contract, the amount specified in that notice;

(b) in a case where a notice complying with section 110A(3) has been given pursuant to and in accordance with a requirement of the contract, the amount specified in that notice;

(c) in a case where a notice complying with section 110A(3) has been given pursuant to and in accordance with section 110B(2), the amount specified in that notice.

23. The words "subject as follows" in s.111(1) refer to the regime of payless notices set out ss.111(3) - (11) inclusive. This is the mechanism by which a party who has received (or indeed in some cases, has sent) a payment notice, can specify its intention to pay less than the amount set out in the payment notice. The provisions are complex. But they are at the heart of the payment regime because, if the sum stated in a

payment notice is not challenged by a valid payless notice, the sum notified in the payment notice (namely the notified sum) is automatically payable. Again, I note that at s.111(7)(b) there is an express provision that the Scheme for Construction Contracts applies in default of an agreement in accordance with the Act.

24. The rest of s.111 provides as follows:

> "(3) The payer or a specified person may in accordance with this section give to the payee a notice of the payer's intention to pay less than the notified sum."
>
> (4) A notice under subsection (3) must specify -
>
> (a) the sum that the payer considers to be due on the date the notice is served, and
>
> (b) the basis on which that sum is calculated.
>
> It is immaterial for the purposes of this subsection that the sum referred to in paragraph (a) or (b) may be zero.
>
> (5) A notice under subsection (3) -
>
> (a) must be given not later than the prescribed period before the final date for payment, and
>
> (b) in a case referred to in subsection (2)(b) or (c), may not be given before the notice by reference to which the notified sum is determined.
>
> (6) Where a notice is given under subsection (3), subsection (1) applies only in respect of the sum specified pursuant to subsection (4)(a).
>
> (7) In subsection (5), "prescribed period" means -
>
> (a) such period as the parties may agree, or
>
> (b) in the absence of such agreement, the period provided by the Scheme for Construction Contracts.
>
> (8) Subsection (9) applies where in respect of a payment -
>
> (a) a notice complying with section 110A(2) has been given pursuant to and in accordance with a requirement of the contract (and no notice under subsection (3) is given), or
>
> (b) a notice under subsection (3) is given in accordance with this section,

but on the matter being referred to adjudication the adjudicator decides that more than the sum specified in the notice should be paid.

(9) In a case where this subsection applies, the decision of the adjudicator referred to in subsection (8) shall be construed as requiring payment of the additional amount not later than -

(a) seven days from the date of the decision, or

(b) the date which apart from the notice would have been the final date for payment,

whichever is the later.

(10) Subsection (1) does not apply in relation to a payment provided for by a construction contract where -

(a) the contract provides that, if the payee becomes insolvent the payer need not pay any sum due in respect of the payment, and

(b) the payee has become insolvent after the prescribed period referred to in subsection (5)(a).

(11) Subsections (2) to (5) of section 113 apply for the purposes of subsection (10) of this section as they apply for the purposes of that section."

25. It should also be noted that the current version of s.111 is rather different to the original section, although it deals with the same underlying topic: what Ramsey J in *Cleveland Bridge* called "the provisions as to notice of intention to withhold payment" (see paragraph 64 of his judgment, set out at paragraph 28 below). The main change is in nomenclature: before the amendments, the relevant notices were called 'withholding notices'; now they are called 'pay less notices'. Their effect is broadly the same.

26. Section 112 is concerned with a power to suspend if payment is not made. It is unnecessary to set it all out, although I do refer to it in paragraphs 65-66 below.

3.2 The Authorities

27. The first case which grappled with the problems created by ss. 104 and 105 of the Act, and the creation of hybrid contracts, was the decision of Ramsey J in *Cleveland Bridge*. There, a claimant's claim for summary judgment was dismissed on the basis that the adjudicator only had jurisdiction to deal with part of the dispute (that is to say, the part dealing with the claims in respect of construction operations) and not the part dealing with non-construction operations. Thus, her single decision on the whole of the dispute was not a decision within her jurisdiction and was neither valid nor enforceable.

28. As to the relationship between the Act and a contract for both construction and non-construction operations, Ramsey J said:

> "64. It also follows that the right to refer disputes to adjudication under section 108, the entitlement to stage payments under section 109, the provisions as to dates of payment under section 110, the provisions as to notice of intention to withhold payment under section 111, the right to suspend performance for non payment under Section 112 and the prohibition of conditional payment provisions under section 113 will only apply to the Subcontract in this case, insofar as the Subcontract relates to construction operations…
>
> 91. It is clear that the legislation could have dealt with agreements which related both to construction operations and to "other maters" being operations which were not construction operations, in a number of ways. It would have been possible to treat them either as being agreements for construction operations or as not being agreements for construction operations. It would also have been possible for that question to depend on the relative values of the construction operations and of the "other matters". It is clear that Parliament decided that, just because an agreement related, in part, to operations which were not construction operations, this did not prevent the implied terms under section 114(4) of the Act from applying to the construction operations. It follows that a party can refer a dispute arising under the agreement, insofar as it relates to construction operations, to adjudication under a procedure complying with section 108 of the Act. In this case the contract contained no provision for adjudication and it is common ground that any adjudication would have to be carried out in accordance with the Scheme for Construction Contracts. ("the Scheme")."

29. As to the question of jurisdiction, Ramsey J said:

> "105. Where a party refers a dispute to an adjudicator who only has jurisdiction in respect of part of that dispute, I do not consider that there is anything, in principle, which prevents the adjudicator from making a decision as to that part of the dispute which is within his or her jurisdiction. In other words, the fact that part of the dispute relates to matters over which an adjudicator has no jurisdiction does not prevent the adjudicator from exercising the jurisdiction that he or she has.
>
> 106. In summary therefore I do not see that there is any objection in the way in which the Notice of Adjudication or the Notice of Referral were drafted which means that, to the extent that the dispute was within the Adjudicator's jurisdiction, she could give a valid decision…
>
> 116. It is clear that if the dispute referred to adjudication in this case had been limited to the part for which the Adjudicator had jurisdiction there would have been a valid adjudication and a valid decision. Where there is an overall dispute as to payment, delay or disruption arising in part from construction operations and in part from other excluded operations then the adjudication provisions cannot be applied to only part of that overall

> dispute. If that overall dispute can be divided so that part of the overall dispute relates only to construction operations then that part can be referred to adjudication."

30. In the first round of *Severfield*, noted at paragraph 11 above, Stuart-Smith J said:

> "14. Since the scheme provisions are only applied to "construction operations" (as defined) and the consequences of obtaining an award which includes matters that are not construction operations is that the award cannot be enforced (see the decision of Ramsey J in Cleveland Bridge) it must be for the claimant who seeks to enforce an award to satisfy the court that all matters that are included in the award were within the jurisdiction of the adjudicator. In this case, it means that the court must be satisfied that all of the steelwork erection included by Severfield in its referral to the adjudicator was properly regarded as "construction operations"…
>
> 17. It seems to me that the question I have to answer is: Can the court be satisfied that the defendant has no reasonable prospect of showing that some of the steelwork for which Severfield has claimed falls within section 105(2)(c) leaving aside, of course, matters which could be regarded as *de minimis*. I can deal with this relatively shortly because, in the end, the relevant evidence is within a very narrow compass. I have already referred to paragraphs 7.4 to 7.6 of Mr De Silva's report at bundle 1, tab 9, 13. Mr Bogg replies to this at bundle 2, tab 11, page 12 at paragraphs 51 to 53 where he says:
>
> "...there is considerable doubt, and it is not clear that, the steelwork to which Mr De Silva refers is actually part of Severfield's Works."…
>
> 26. I fully accept that there may be cases (of which this may be one) where that approach may mean that unmeritorious, technical defences may be made which will deprive people of the cash flow which is the life blood of the construction industry; however, that is not, I am afraid, a sufficient reason for me to bend what I think are the applicable principles. It follows that leave to defend will be given…

31. Severfield then purported to make a very similar claim, this time on the basis that the entirety of their claim was in respect of construction operations only. At [2015] EWHC 3352, I rejected that revamped claim on the facts, noting:

> "21. Beyond the passage to which I have referred in the judgment of Ramsey J in *Cleveland Bridge* (paragraph 19 above), there is no other authority which addresses the question of what payment provisions apply to a hybrid contract. At one point, it was apparent that Mr Hickey was itching to submit that the provisions in the 1996 Act ought to be incorporated wholesale, even in a hybrid contract, to apply to all the works. But it seems to me that, first, that submission would have run counter to s.104(5), which expressly provides that the provisions in the Act apply "only so far as" they relate to construction operations; and secondly, ignores the fact that the parties have expressly agreed a different payment regime (paragraph 6

> above). In my view, the court must uphold that different regime in respect of all claims to payment in respect of works which are excluded by the 1996 Act.
>
> 22. This means that, under a hybrid contract such as this, there are two very different payment regimes. That is what Ramsey J indicated in *Cleveland Bridge*. Although I find that uncommercial, unsatisfactory and a recipe for confusion, it is the inevitable result of Parliament's desire to exclude what would otherwise have been obvious construction operations from the ambit of the 1996 Act."

32. As to the defendant's liability to pay the notified sum, I said:

> "33 That interpretation is reinforced by a consideration of the next statutory requirement, that in order to be payment notice, the notice has to set out the basis on which the sum claimed has been calculated. Because the notice of December 2014 and the accompanying spreadsheet did not begin to address the complexities of what were and were not construction operations, interim payment claim 15 was for everything. There was therefore no explanation in the payment notice of the calculation of £1.4 million as being the minimum due in respect of construction operations within the 1996 Act. So it 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.
>
> 34. Thirdly, I have concluded that, in so far as it is now said that the notice of December 2014 is a payment notice for £1.4 million in respect of construction operations, such a claim is not at all clear or unambiguous from a perusal of either the notice or the accompanying spreadsheet. How could it be, when the claimant was claiming for everything, regardless of whether or not the works were construction operations within the Act? Because this was a hybrid contract, it was imperative that the claimant spell out the fact that, regardless of the position in relation to excluded operations, this was a payment notice (with all that that entailed) in respect of the claim for construction operations."

4. THE JUDGMENT OF O'FARRELL J

33. The heart of the judge's judgment is at [56] – [64]. It is appropriate to set out those paragraphs in full, since this appeal largely turns on whether or not her analysis in these passages was correct.

> "56. In my judgment where, as here, a hybrid contract contains a payment scheme that complies with, or mirrors, the relevant provisions of the Act for both construction and non-construction operations, a payment notice that does not separately state the sums due in respect of the construction operations is capable of constituting a valid notice for the purposes of sections 110A and 111 of the Act for the following reasons.

57. Firstly, the express words of sections 111 and 110A do not stipulate separate identification of the sums due in respect of construction operations. Section 111 simply identifies the "notified sum" by reference to a valid payment notice in section 110A. Section 110A(2) contains two requirements for a valid payment notice, namely, the sum considered due at the payment due date and the basis on which that sum is calculated. To comply with section 110A(2), the sum considered due must include, but is not expressly limited to, such sum in respect of construction operations. That may be satisfied by stating the overall sum considered due in response to the relevant application.

58.Secondly, although the statutory provisions apply only to the construction operations under a contract, as explained above, it is open to the parties to agree a payment scheme that sits alongside the statutory provisions, such that it complies with the statutory provisions in respect of construction operations and mirrors those provisions in respect of other operations. In such circumstances, it is possible for a payment notice to satisfy both the statutory requirements (in respect of construction operations) and the contractual requirements (in respect of non-construction operations). Such a payment notice could be valid under the contract and under the Act.

59. Thirdly, as a matter of principle, there is no difficulty in implementing section 111 where the same provisions apply to both construction and non-construction operations. I agree with CSL that, where separate payment machinery applied, as in the case of *Severfield*, it would be necessary to distinguish construction operations from non-construction operations in respect of each application notice and payment notice. Otherwise, it would not be possible to identify the notified sum which became payable pursuant to section 111. There might also be cases where one party sought to enforce section 111 in isolation from any contractual entitlement to a payment. In such cases, it would be necessary for the party seeking to rely on section 111 to identify the notified sum to which the section applied so that the default provision in section 111 could be implemented. However, such difficulty would not arise where the same provisions applied to both construction and non-construction operations, whether by way of statutory requirement or contractual obligation. As a matter of principle, validity of the payment notice in respect of both the construction and non-construction operations would be determined against the same parameters. In such cases, it would be possible to identify the sum payable by way of each interim payment, applying section 111 (in respect of the claims for construction operations) together with the provisions replicated in the Subcontract (in respect of the claims for non-construction operations).

> 60. Fourthly, the above approach does not undermine the purpose of the statutory payment provisions. It could be described as a pragmatic solution to the illogical and uncommercial impact of section 104(5) of the Act. If parties agree a payment scheme that complies with, or mirrors, the statutory scheme in respect of both construction and non-construction operations, the cash flow benefits conferred by the Act are simply extended to cover those additional works.
>
> 61. In this case it is necessary for CSL to distinguish between the sums claimed for construction operations and sums claimed for other works because it seeks to limit its claim to the notified sum payable pursuant to section 111 of the Act. However, it is open to MW to defend that claim by relying on a payment notice, setting out the basis on which no sum is due in respect of any construction or non-construction operations.
>
> 62. Of course, it is necessary to construe each payment notice against the relevant contractual and statutory background to determine its validity. A payment notice must be sufficiently clear and unambiguous in form, substance and intent so that the parties have proper notice of the sum assessed as due and the basis of calculation. It is possible that a paying party who declined to apportion or allocate the sums due or deducted as between construction and non-construction operations might struggle to rely on its notice for the purpose of the Act if a deficiency in the notice undermined the validity of its global assessment. No such issue has been identified in this case.
>
> 63.MW's payment notice 35 set out the sum which the contract manager considered due at the relevant date and the basis on which it was calculated. I am satisfied that on a proper construction of the Subcontract and the Act, MW issued a valid payment notice in response to CSL's application no.32.
>
> 64.The issue of a valid payment notice by MW is sufficient to defeat CSL's claim for monetary relief in these proceedings and dispose of the Part 8 claim..."

5. THE CENTRAL ISSUE ON THE APPEAL

34. Although the arguments during the hearing ranged relatively far and wide, the principal issue boiled down to a relatively straightforward point of statutory and contractual interpretation. On behalf of CSL, Mr Nissen QC argued that the words of s.104(5) ("only so far as it relates to construction operations") had to be read into every section and sub-section of the Act concerned with payment, namely ss.109 –

111. As consequence, he said that the notified sum had to be in respect of construction operations, so that, where the contract was a hybrid contract, including both construction and non-construction operations, a failure to specify, within the overall sum notified, the amount that related to construction operations only, was a failure to comply with the Act.

35. On behalf of MW, Mr Hargreaves QC submitted that there was no need to read into the subsequent sections of the Act and/or the payment provisions of the sub-contract any such qualification. He contrasted those payment provisions with the adjudication provision in the sub-contract, which did expressly make the distinction. He said that to read in the additional words was unnecessary, and that to do so would result in confusion, complexity, and additional cost.

6. ANALYSIS

36. I have not found this issue entirely straightforward; like most debates arising out of hybrid contracts, because of the artificial circumstances created by the Act, it is not hard to see the merits of both sides' submissions. However, I have reached the firm conclusion that the judge was right to reject CSL's interpretation, largely for the reasons that she gave. My own analysis is set out below.

6.1 The Starting Point: The Sub-Contract Terms

37. I start with the sub-contract terms. It was common ground that there was nothing in the terms of the sub-contract which required either side to differentiate in their payment notices or payless notices between the sums notified for construction operations, and the sums notified for non-construction operations. In other words, the express terms agreed by the parties were contrary to CSL's case on appeal.

38. Mr Nissen argued that the sub-contract terms were of limited importance because what mattered was the Act. He also said that, since the whole basis of the Act was contrary to the general principle of freedom of contract, it was inappropriate to start any analysis by reference to the terms of the sub-contract. I disagree with those submissions.

39. What the Act does is to identify certain minimum provisions, as to payment and as to dispute resolution by way of adjudication, which every construction contract must contain. Thus, any analysis must start with the contract terms, in order to see if they comply with the Act. The Act itself envisages that the parties will contract on terms which they agree between themselves. If the agreed terms comply with the Act, then the conventional view is that the Act is no longer of any direct relevance to the rights and obligations of the parties[2].

40. In connection with the importance to be accorded to the terms of the sub-contract, Mr Hargreaves submitted that, whilst parties cannot contract *out* of the Act (ie agree terms of a construction contract which do not contain the minimum requirements set out in ss.109-111 inclusive), it is perfectly permissible for parties to contract *in*, by

[2] For the reasons set out in Section 7 below, it is unnecessary for the disposition of this appeal to decide whether s.111 provides a statutory right regardless of the terms of the sub-contract.

which he meant (in the context of this case) that the parties were at liberty to agree payment terms which complied with the Act in respect of both construction *and* non-construction operations. I agree with that: it is a point to which I return below.

41. Moreover, as Schedule A to MW's written skeleton argument makes clear, such 'contracting in' now appears to be commonplace in the standard forms of sub-contract used in those industries which, at the time that the Bill was originally before Parliament, appeared anxious to avoid such minimum payment requirements. In other words, through the principle of freedom of contract, the construction industry seems to have found a practical way round at least some of the complications introduced by hybrid contracts.

6.2 Compliance with the Act

42. Accordingly, the next question is whether the terms of the sub-contract were, in some way, in contravention of the minimum requirements of the Act. If they were, then of course any non-compliant terms will not apply and, by operation of ss.109-111, the Scheme for Construction Contracts will apply instead. What could any potential non-compliance be? In this case, the only possible candidate is whether there is some part of the Act which requires, in a hybrid contract, payment terms which provide for the separate or distinct notification and breakdown of sums due in respect of construction operations only.

43. In my view, there is nothing in the Act which sets out such a requirement. S.104(5) expressly recognises that, because of the distinction that the Act makes between construction and non-construction operations, there will be hybrid contracts. Indeed, as Mr Hargreaves submitted, this part of the Act created such contracts: without its distinction between construction and non-construction operations, there would be no such thing as a hybrid contract at all. But although the Act created such contracts, it does not provide that a hybrid contract must contain a term requiring the separate or distinct notification and breakdown of sums due in respect of construction operations only.

44. If it was important for hybrid contracts to contain terms which provided for the notification and breakdown of sums due in respect of construction operations only, then the Act could easily have said so. For example, it could have provided that "the notified sum" in ss.110 and 110A was a sum in respect of construction operations only and/or must not include any sums in respect of non-construction operations. But the Act does not do that. Nowhere in ss. 110, 110A, 110B or 111 does the Act provide that the expression "the notified sum" should be modified in this way.

45. Moreover, I consider that this would be a significant modification. As has been pointed out in numerous authorities, the parties' critical obligations begin and usually end with the payment of "the notified sum". If CSL was right then, in every hybrid contract created by s.104(5), "the notified sum" would not be the full sum due to the payee, but just that part which related to construction operations. Alternatively, CSL's case would lead to there being two different notified sums, one in respect of construction operations, and one in respect of non-construction operations. In my view, such significant qualifications to the parties' statutory or contractual rights would need to be clearly expressed in the Act. But they are not.

46. For example, s.110A contains clear stipulations as to what the relevant payment notices must contain. It specifies that the payment notice must identify the sum due and the basis on which that sum has been calculated. There are no other requirements. Thus, as the judge found at [57], the requirement upon which CSL seek to rely (namely that the notified sum must be in respect of construction operations only) cannot be found in the relevant sections of the Act.

47. For those reasons, I consider that the payment provisions in the sub-contract comply with the mandatory requirements of ss.109-111 of the Act. There was no requirement on either side to notify and break down sums due in respect of construction operations only.

6.3 'Reading In'

48. CSL argue that the words "only in so far as it relates to construction operations" in s.104(5) should be "read in" to all the later sections of the Act. That is always a difficult argument to run, because it suggests, however gently, that the drafting of the statute is deficient or, at the very least, incomplete. That submission faces a further obstacle in circumstances where, as here, the Act can be construed perfectly well without reading in any words at all. In my view, it is neither necessary nor appropriate to read in those words from s.104(5).

49. In support of his 'reading-in' argument, Mr Nissen principal submission was that the words were not expressly set out in the payment provisions because s.111 (and for that matter ss.110, 110A and 110B) had been drafted on the assumption that it related to construction contracts only. In other words, he said that it was artificial to rely on the fact that these provisions did not include the words on which he now relies, when that omission only occurred in the first place because the payment provisions in the Act presumed that the contracts with which they were concerned were construction contracts only.

50. I cannot accept that submission. The Act created hybrid contracts in ss. 104 and 105. It must therefore be taken to have them very much in mind in its subsequent provisions. What is more, those provisions cannot be read in isolation, ignoring what has come before. The sections of the Act with which this appeal is concerned relate to construction contracts and (if that is what the parties agree) hybrid contracts too. It is therefore no answer to say that the words now relied on as being 'read in' were not expressly stated because the relevant sections of the Act presupposed that the contract in question was a construction contract. S.104(5) makes clear that any such presumption is erroneous.

51. It is important to understand what s.104(5) is doing. It is making plain that parties can have a hybrid contract if that is what they want but, if they do, they cannot contract out of the Act in respect of construction operations. As explained further below, it seems to me that s.104(5) does not prevent the parties from contracting in, if that is also what they want. It would therefore be contrary to s.104(5) to use it as a means of restricting the parties' rights and liabilities.

6.4 Extension of the Statutory Provisions to Non-Construction Operations

52. To the extent that there was an issue between the parties about the extension of the statutory provisions to non-construction operations, I consider it clear that the parties were at liberty to extend the payment provisions deriving from ss. 109-111 to cover both construction operations and non-construction operations. That is the point made by the judge at [58], and already foreshadowed in paragraphs 40 and 51 above. In my view, that approach is not only permissible, it is to be welcomed, for the reasons that I have already given. The fact that the parties have agreed that the same payment provisions as set out in the Act will apply to both construction and non-construction operations does not require the parties to differentiate between different parts of the sub-contract works in the manner suggested by CSL. The terms of the sub-contract evidence their intention to do the opposite and, provided that by so doing they were not in breach of the Act (as I have found) they are entitled to rely on the sub-contract terms which they have agreed.

53. Mr Nissen maintained that, whilst parties could theoretically extend the payment provisions to deal with non-construction operations, they could not, in so doing, subsume the rights which they were granted pursuant to the Act. I accept that in principle: as I have said, if there is a clash between the terms of a contract and the Act, then the Act must prevail. But that only applies at all if there is a statutory right which is being lost. Here, there is a right/liability under the Act to be paid/to pay the notified sum (singular). That right is preserved by the sub-contract in the present case. No statutory rights have therefore been lost. They have instead been augmented by agreement.

6.5 The Comparison with the Adjudication Provision

54. The importance of the difference between construction and non-construction operations under a hybrid contract only arises if there is a dispute as to the sum due. That is what *Cleveland Bridge* is all about. If sums are duly notified and paid in respect of the works as a whole without dispute, then the distinction does not matter. But it will matter if or when there is a dispute about the sum due. That is because, if there is such a dispute, the next question will be the appropriate mechanism for its resolution. In particular, whether the dispute can be referred to adjudication will depend on whether the dispute relates to construction or non-construction operations, (because - unless it is extended by agreement - the adjudicator only has jurisdiction to deal with the former). That is why the distinction between the two types of operation under a hybrid contract will matter at the time that a dispute arises.

55. On this issue too, the provisions of the sub-contract run counter to CSL's position. As noted in paragraph 11 above, the adjudication provision at Clause 44.1 of the sub-contract was narrowed by agreement, so that it related only to construction operations. In other words, the adjudication clause recognised that this was a hybrid contract and made plain that the adjudication provisions only related to referrals in respect of construction operations. The same limitation could have been included in the payment provisions of the sub-contract, but was not. That indicates that the parties were content to rely on the payment provisions derived from the Act in respect of both construction and non-construction operations, but that in respect of the dispute resolution mechanism, they were limiting the adjudication provision to disputes in respect of construction operations only. That was consistent with the need for a distinct allocation at the referral stage (if that stage was reached) but not before, which was MW's case.

56. Mr Nissen complained that, if that was right, CSL were prejudiced because, if they wanted to challenge MW's payment notice 35, they would not necessarily know which were construction operations and which were not. I have sympathy with that submission although I consider it to have been over-stated. If they had wanted to challenge payment notice 35 in an adjudication, then CSL could have done so, and left it to MW to take a jurisdiction point, which they might or might not have done and which may or may not have been successful. Or CSL could have waited and then themselves have taken a jurisdiction point if MW had pursued their own claim for £6.5 million in adjudication. Or, given that this was at the end of the works on site, CSL could have pursued a final account claim in litigation, which would have addressed the underlying merits of the claims and cross-claims, rather than the technicalities of the Act.

57. All of that is entirely conventional: it is always for the party making the claim in adjudication to establish the necessary jurisdiction (see the passage from the judgment of Stuart-Smith J in *Severfield* cited in paragraph 30 above). I accept at once that CSL are entitled to feel aggrieved, because MW took the point against them in relation to application 31 which CSL now wish to turn back on MW in respect of application 32. But for the reasons I have explained, there is a critical difference between the payment terms and the adjudication provision, and the difference again supports MW's interpretation. In addition, I do not accept the suggestion that this has given rise to any substantial prejudice to CSL.

6.6 The Application of the Authorities

58. I have already explained how the judge's solution is in accordance with the decisions in *Cleveland Bridge* and the first round of *Severfield*.

59. In addition, the parties' agreement (as set out in the payment terms of the sub-contract) is one of the principal reasons why this case is different to the situation in *Severfield*. As noted in the passages of my judgment in the second round of that case (set out at paragraphs 31 and 32 above), there were two different contractual payment regimes there, because the express terms in respect of the construction operations did not comply with the Act. The payment provisions in the Scheme therefore had to be incorporated in respect of construction operations, whilst the contractual provisions remained in force in respect of the non-construction operations. This case is different: here, not only did the contractual provisions in respect of construction operations comply with the Act, but the parties saw to it that the sub-contract also mirrored the provisions of the Act for non-construction operations as well.

60. In my view, despite Mr Nissen's close textual analysis (and criticisms) of the passage, that was the simple point being made by the judge at [59] (set out at paragraph 33 above). She was contrasting the situation that arose in *Severfield*, where there were two separate payment regimes, with the situation here, where there was only one (either under the sub-contract or by reference to s.111). It would be absurd if two separate payment regimes had to be created here (which would be the result if CSL was right about the need to identify the sum due within each milestone payment or claim in respect of construction operations only) when a single, compliant payment regime had been agreed by the parties.

6.7 The Purpose of the Act

61. At [60], the judge said that her interpretation was in accordance with the purpose of the Act, with its emphasis on stage payments. That is an observation with which I respectfully agree. Her approach does not undermine the purpose of the Act; on the contrary, it confirms that purpose, by upholding the validity of stage payments for the totality of the works under this hybrid contract, regardless of whether they were for construction or non-construction operations.

62. In addition, the Act also aimed at greater certainty and greater transparency in relation to such stage payments. I consider that the approach outlined above provides that too. Under contracts to which the Act applies (whether construction contracts or hybrid contracts), both the paying party and the payee will be primarily concerned with what they are contractually required respectively to pay and to receive at each stage of the works. Certainty and transparency are achieved if the stage payment is a single sum based on a monthly valuation or, as here, on the achievement of a particular milestone. Neither the payer not the payee wants to end up in the position of the parties in *Severfield*, with two separate processes, subject to different procedural requirements, to produce two separate sums. That level of uncertainty is, in my view, contrary to another of the purposes of the Act.

6.8 Practical Considerations

63. Finally, I am in no doubt that requiring parties to a hybrid contract to deal separately with construction and non-construction operations for every interim payment application, in circumstances where they have agreed one set of payment terms for both types of operation which comply with the Act, would create additional layers of complexity and cost. Mr Nissen fairly conceded that, if he was right, it would be a change to the way in which the industry currently deals with hybrid contracts. And, as Mr Hargreaves demonstrated during his submissions, it may well be very difficult, if not impossible, to undertake such an allocation in a contract such as this, where the parties have agreed milestone payments. There is at least a risk that, if CSL were right and an allocation had to be performed, the parties would be obliged to carry out a detailed valuation exercise (to differentiate between construction and non-construction operations) in respect of milestone payments which, pursuant to this sub-contract, were fixed in a single sum by reference simply to the completion of a particular stage of the work.[3]

6.9 Other Matters

64. Mr Nissen advanced an alternative argument to the effect that, if the sub-contract conditions did not comply with the Act, then he was entitled to rely on the Scheme, and that paragraph 9 of the Scheme plainly envisaged payment provisions in relation to construction operations only. I do not necessarily agree with that categorisation of paragraph 9 (which I note contains no cross-reference to s.111) but, in circumstances where the point does not arise – because I am satisfied that the express terms of the sub-contract do not contravene the Act – it would be counterproductive to say more.

[3] Although it is unnecessary to set them all out in detail, I agree with Mr Hargreaves's lengthy list of concerns about the practical effect of the change which CSL wanted: the requirement to allocate would be time-consuming and expensive; it would apply to both main contracts and sub-contracts; it would not streamline the industry; and it might have a significantly deleterious effect on the presentation of contractual claims, including claims for delay.

65. Mr Nissen also complained that the suspension provision at s.112 of the Act would not work if it applied to a hybrid contract. He also made a wider submission that the term in the sub-contract dealing with suspension was materially different to s.112 and did not comply with the Act. It seems to me that these were separate points, to be determined if and when there was an attempt by CSL to suspend for non-payment. In any event, even if the latter point was right, the only result would be the replacement of the contractual suspension provision with the applicable paragraph from the Scheme.

66. These points were not argued before the judge, so they are not dealt with in her judgment. They do not affect the outcome of the dispute as to the alleged requirement to allocate a sum in respect of construction operations only, with which I have dealt above, and which lies at the heart of the appeal. It is therefore unnecessary for this Court to determine them.

67. For all those reasons, therefore, attractively though the points were argued, I reject CSL's submissions. In my view, the judge reached the right answer. Moreover, her approach has the additional advantage (not to be overlooked in these adjudication cases) of being a sensible and pragmatic resolution of the issue.

7. THE STATUS OF SECTION 111

68. During the course of his submissions, Mr Nissen relied on observations by Jackson LJ in *S&T (UK) Limited v Grove Developments Limited* [2018] EWCA Civ 2448, in which he suggested at paragraphs 40 - 42, and again at paragraph 99, that s.111 not only overrode any contractual provisions which provided otherwise, but was also the principal source of the obligation to pay the notified sum, even if the contract said the same thing. The former observation was of course entirely conventional; with respect, the latter was not. Although this issue was not fully argued out in this appeal, I have given the matter careful thought, but I have concluded that I do not need to (and should not) address this issue in this judgment. There are a number of reasons for that.

69. First, I note that this point does not arise from the judge's judgment. It does not appear that the point was developed before her. She approached the issues on the conventional basis that, if the payment terms in the contract complied with the Act, they were valid. Likewise, it was not fully argued before us.

70. Secondly, I do not consider that it is necessary to decide whether Jackson LJ's observation is right or wrong for the purposes of this appeal. The analysis which I have set out above is applicable regardless of whether the right to payment of the notified sum as set out in s.111 is paramount, or whether that right was a creature of a sub-contract which (as I have found) did not contravene the Act. Either way, on Mr Nissen's case, words have to be read in to achieve the result which he wants and, for the reasons which I have given, I do not accept that such a mechanism is either appropriate or necessary.

71. Thirdly, contrary to Mr Nissen's helpful post-hearing note, I do not consider that Jackson LJ's observations were part of the *ratio* of the Court of Appeal's decision in *Grove*. The point about s.111 arose in relation to one of six separate reasons why the first instance judge, and the Court of Appeal, decided the case in favour of the employers. His observations appear to go to a secondary issue about the potential

clash between the adjudication regime and the prompt payment regime. The result in *Grove* would have been precisely the same if the right which Jackson LJ identified had been expressed as a contractual rather than a statutory right.

72. Fourthly, Mr Nissen (who appeared for the successful party in *Grove*, and without whom no major adjudication case would be complete) indicated during the course of argument on this appeal that the point had not been the subject of any debate in the Court of Appeal in *Grove*. There may well have been good reasons for that, but this information only served to increase my caution about accepting these *obiter* observations without demur.

73. Finally, as is probably apparent by now, until I hear detailed argument on this issue in a case where it matters to the outcome, I retain at least some doubt about their correctness. On their face, they might be said to turn the conventional approach (whereby one checks the contract against the minimum requirements of the Act and concludes whether it is the contract or the Act – and therefore the Scheme - which gives rise to the relevant rights and obligations) on its head. They appear to be suggesting that, at least for the purpose of the obligation to pay the notified sum, the contract is irrelevant, even if that contract meets all the minimum terms required by the Act. That may be right, but it might be thought to be a potentially surprising result. There seems to me to be nothing obvious on the face of s.111 which suggests that it is creating a completely different right to those created by ss.109-110B inclusive. In addition, I am not entirely clear how a provision like s.111, which started life dealing with the need for a construction contract to enshrine a party's right to withhold payment of the sum due (if that party complied with the specified procedure) should now be read as creating a statutory right to be paid the notified sum regardless of the contract terms.

74. For all these reasons, I am wary of venturing further into this topic, let alone deciding the issue. Since it was not fully argued in *Grove*, and made no difference to the outcome in that case, and since it was not fully argued in this appeal, and again makes no difference to the outcome in any event, I would not wish to comment upon it further.

8. CONCLUSION

75. For the reasons that I have given, if my Lords agree, I would dismiss this appeal.

LORD JUSTICE BAKER:

76. I agree.

SENIOR PRESIDENT OF TRIBUNALS:

77. I also agree.