PAYMENT MECHANISMS AND CONSTRUCTION CONTRACTS: A CLARIFICATION

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"Construction contracts which fix the final date for payment otherwise than by reference to a period of time following the due date do not comply with the 1996 Act."

INTRODUCTION

The English Technology and Construction Court ("TCC") recently clarified a key issue in relation to contractual payment mechanisms and the Housing Grants, Construction and Regeneration Act 1996 ("1996 Act"). In *Lidl Great Britain Limited v Closed Circuit Cooling Limited t/a 3CL* [2023] ("*Lidl*"), the TCC confirmed that construction contracts which fix the final date for payment otherwise than by reference to a period of time following the due date do not comply with the 1996 Act. As a result, a payment mechanism in a construction contract governed by the 1996 Act which fixes the final date for payment by reference to an event, such as the issuance of an invoice, rather than as a set period of time following the due date, will be unenforceable to that extent, being replaced to the same extent by the relevant provisions of the Scheme for Construction Contracts.

The decision confirms the *obiter dicta* comments of Cockerill J in *Rochford Construction Limited v Kilhan Construction Limited* [2020] EWHC 941 ("Rochford") and re-emphasises the importance of parties ensuring that their contractual payment mechanisms comply with the requirements of the 1996 Act.

BACKGROUND

"The parties disputed whether the payment terms of the contract complied with the requirements of the 1996 Act."

3CL, an industrial refrigeration and air-conditioning contractor, entered into a framework agreement with Lidl, the well-known supermarket chain. The framework agreement provided for the parties to enter into individual work orders, each of which constituted a separate contract for the specific work item and incorporated both the terms of the framework agreement and the order.

A dispute arose between the parties in respect of an application for interim payment made by 3CL to Lidl ("AFP 19") under the first work order. In response to AFP 19, Lidl issued a document which, it argued, was a valid payment notice that valued the work at nil. Furthermore, the contract between Lidl and 3CL provided that the final date for payment would fall "*either 21 days following the due date or receipt of the Contractor's valid VAT invoice, whichever is the later*". Lidl contended that 3CL had submitted no such invoice, so no sum was owing.

Among other issues, the parties disputed whether the payment terms of the contract complied with the requirements of the 1996 Act. 3CL's position was that this clause failed to comply with section 110(1)(b) of the 1996 Act which only permits parties to agree a time period between the due date and the final date for payment and does not permit parties to fix the final date for payment by reference to the occurrence of an event (such as the issuance of an invoice). Lidl contended that the 1996 Act imposed no such constraints and that the clause complied with the 1996 Act.

In the adjudication which preceded the TCC proceedings, the adjudicator decided in 3CL's favour, ordering Lidl to pay the sum applied for in AFP 19 with interest. In response to that decision, Lidl issued Part 8 proceedings seeking a declaration (among others) that the parties' agreement as to the final date for payment complied with section 110(1)(b) of the 1996 Act. 3CL, in turn, issued Part 7 proceedings and an application for enforcement of the adjudicator's decision, which was heard together with Lidl's Part 8 claim.

"The final date has to be pegged to the due date, and be a set period of time."

THE TCC PROCEEDINGS

The case before the TCC raised the question, among others, of whether a contractual payment mechanism complies with the 1996 Act where it provides for a final date for payment to be fixed other than by a specified period of time after the due date.

Central to the court's analysis was section 110(1)(b) of the 1996 Act, which provides that "*The parties are free to agree how long the period is to be between the date on which a sum becomes due and the final date for payment*". The court contrasted this wording with the drafting of section 109(2) of the 1996 Act, which provides in respect of due dates, "*The parties are free to agree the amounts of the payments and the intervals at which, <u>or circumstances in which</u>, they become due*" (emphasis added).

The court considered in some detail the judgment in *Rochford*. In that decision, Cockerill J considered (*obiter dicta*) that "*properly construed, section 110 required a final date for payment provision to fix a time period, albeit that that might itself depend on an event to fix the due date*", which "*suggests that while a due date can be fixed by reference to, say, an invoice or a notice, the final date has to be pegged to the due date, and be a set period of time, and not an event or a mechanism*".

The court went on to comment in turn upon several purportedly conflicting authorities: *VHE Construction plc v RBSTB Trust Co Limited* (2000), *Alstom Signalling Limited v Jarvis Facilities Limited* (2004), *Manor Asset Ltd v Demolition Services Ltd* (2016) and *Volkerlaser Limited v Nottingham City Council* (2016). On analysis, however, *Alstom* did not contradict Cockerill J's conclusion in *Rochford*. The remaining three cases were not persuasive authority because in those cases (a) the particular point had not been subject to argument, (b) it had not been identified by the judges themselves as requiring consideration and (c) no reasons had been given as to why calculating the final date for payment otherwise than solely by reference to a fixed period after the due date did not contravene section 110(1)(b) of the 1996 Act.

"The 1996 Act gives parties latitude to agree the length of the time period between the date due for payment and the final date for payment, but no more."

Accordingly, the court was persuaded to follow Cockerill J's *obiter dicta* conclusion in *Rochford* that the 1996 Act gives parties latitude to agree the length of the time period between the date due for payment and the final date for payment, but no more. On the facts of the case, the payment mechanism under the contract allowed for the final date for payment to be "*entirely dependent on the date of 3CL's invoice*", which did not comply with the requirements of section 110(1)(b). The consequence was that the Scheme for Construction Contracts was implied to the required extent, overriding the agreed mechanism for determining the final date for payment.

COMMENT

The judgment in *Lidl* has settled the matter that a contract which fixes the final date for payment by reference to something other than a period of time following the due date does not comply with the 1996 Act. A contractual payment mechanism which interposes the occurrence of a further event between the due date for payment and the final date for payment as the basis for calculating the final date for payment will be unenforceable, and the Scheme will be implied into such a contract to that extent.

"Scheme for Construction Contracts was implied to the required extent, overriding the agreed mechanism for determining the final date for payment."

The implications of this decision are potentially very wide indeed and parties should consider the judgment with some care. If, and to the extent that, the payment mechanisms in their contracts make the final date for payment contingent upon something other than a fixed time period from the due date, it may be that the final date for payment differs from what is apparent on the face of the contract. As a consequence, it may also be the case that the deadlines for issuing pay less notices under those contracts differ from what the parties believe them to be.

Parties that believe that their contracts may be affected by the *Lidl* decision should seek to regularise those contracts by making amendments to bring them into compliance with the 1996 Act or, alternatively, by notifying the counterparty that the paying party will be adopting the relevant parts of the Scheme to the necessary extent, seeking their agreement in the light of the *Lidl* decision. In the meantime, those same parties should take care when issuing or assessing pay less notices to ensure that the notices have been served in time.

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