

Construction Ruling Clarifies Key Payment Mechanism Issue

By **Rebecca Williams and Jack Moulder** (October 3, 2023)

In a judgment handed down on Sept. 11 in *Lidl Great Britain Ltd. v. Closed Circuit Cooling Ltd. t/a 3CL*,^[1] the English Technology and Construction Court clarified a key issue in relation to contractual payment mechanisms and the Housing Grants, Construction and Regeneration Act 1996.

The court confirmed that construction contracts that 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 that 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 Judge Sara Cockerill in *Rochford Construction Ltd. v. Kilhan Construction Ltd.*,^[2] another case before the court.

That case, in which judgment was handed down on March 12, 2020, reemphasises the importance of parties ensuring that their contractual payment mechanisms comply with the requirements of the 1996 act.

For practitioners, it will be important to consider whether contracts fall within the scope of the 1996 act and if so, whether the mechanism for determining the final date for payment complies with it.

If it does not comply, then the paying party could be unknowingly issuing both pay-less notices and payments late, with the attendant risk of facing a smash-and-grab adjudication by the payee.

Background

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 regarding AFP 19, an application for interim payment under the first order. After 3CL issued AFP 19, Lidl issued a document that 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



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no sum was owed.

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 that preceded the court proceedings, the adjudicator decided in 3CL's favor, 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 Court Proceedings

The case before the court raised the question, among others, of whether a contractual payment mechanism complies with the 1996 act if 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, or circumstances in which, they become due."

The court considered in some detail the judgment in Rochford. In that decision, Judge Cockerill considered 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."

According to her, this "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 of the court: VHE Construction plc v. RBSTB Trust Co. Ltd., handed down on Jan. 13, 2000; Alstom Signalling Ltd. v. Jarvis Facilities Ltd., handed down on May 28, 2004; Manor Asset Ltd. v Demolition Services Ltd., handed down on Feb. 15, 2016; and Volkerlaser Ltd. v Nottingham City Council, handed down on July 7, 2016.

On analysis, however, Alstom did not contradict Judge Cockerill's conclusion in Rochford.

The remaining three cases were not persuasive authority because in those cases,

- The particular point had not been subject to argument;
- It had not been identified by the judges themselves as requiring consideration; and
- 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.

Accordingly, the court was persuaded to follow Judge Cockerill'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 confirmed that a contract that 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 that 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.

Indeed, the implications of this decision, for both paying parties and payees, are potentially very wide 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.

It may be that paying parties under such contracts are unwittingly issuing pay-less notices late, exposing themselves to the risk of a smash-and-grab adjudication.

A typical so-called smash-and-grab adjudication arises where a paying party under a construction contract fails to serve a timely payment notice or pay-less notice in response to a payment application from the payee under that contract.

As a result, and assuming that the paying party fails to pay in full the sum claimed in that payment application, the payee will be entitled to immediately commence an adjudication against the paying party to recover in full the sum for which it has applied.

In such circumstances, any dispute which may exist as to the substance of the sums claimed will be no defense to the requirement for the paying party to pay that notified sum.

Parties that believe that their contracts may be affected by the Lidl decision should seek to amend those contracts 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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[1] Lidl Great Britain Limited v. Closed Circuit Cooling Limited t/a 3CL[2023] EWHC 2243 (TCC).

[2] Rochford Construction Limited v Kilhan Construction Limited [2020] EWHC 941.