UNITED KINGDOM

HYBRID CONTRACTS – IS ADJUDICATION THE CORRECT VEHICLE?

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Earlier this year a case regarding the enforcement of an Adjudicator's decision for a dispute that arose on a Biomass Power Plant came out of the TCC. This case was the latest judgement to grapple with a contract containing operations that are expressly excluded by s105(2) of the Housing Grants Construction and Regenerations Act 1996 as amended ("the Act"). At first blush, one may assume that a Construction & Engineering Contract for the construction of a power plant is excluded by the Act. However, this case reassures the industry that construction contracts can be hybrid in nature when considering the right to adjudicate and the s105(2) exclusions.

This case brought two primary issues before the Judge, the first being a matter of jurisdiction and s105(2) excluded operations, the second was related to the first and posed the question of whether the Contractor had properly reserved its right during the adjudication, to argue that the Adjudicator did not have jurisdiction to decide the dispute.

THE FACTS

The Employer engaged the Contractor to design and build a Biomass Fired Energy Generating Plant ("the Project").

Progress on the Project was slow and in February 2017 the Employer commenced an adjudication ("the first adjudication"), seeking a declaration that the Contractor was not entitled to an extension of time. The Adjudicator decided in favour of the Employer and decided that the Contractor was responsible for the delays on the Project.

Following the first adjudication, the Employer terminated the contract and the Project was shelved. Shortly after this, the Employer implemented a clause in the contract which allowed it to compile and issue an Interim

Account to the Contractor to recover its losses, where it was alleged that the Contractor was liable for over £11million. The costs in this Interim Account were related to preparatory work such as financial close, design, placing of orders and the site compound as the Contractor had not yet commenced any excavation on site at the point of termination.

A dispute arose as to the validity of the termination of the Contract and the value of the Interim Account. The Employer subsequently referred the dispute to Adjudication in October 2017 ("the second adjudication"). The Employer was successful once again and the Adjudicator decided that termination of Contract was lawful, and that the sums payable to the Employer in respect of the Interim Account were just short of £10 million, including interest on the sum(s) decided.

The Contractor failed to pay the Adjudicator's award and the Employer sought to enforce the decision in the Courts. The Contractor resisted enforcement posing two issues for the Court to decide:

(i) The contract contained works that are excluded from the Act by virtue of s105(2), and therefore the Adjudicator did not have the threshold jurisdiction to decide the dispute,

(ii) Did the Contractor properly reserve its right in the second adjudication in order to argue the jurisdiction point in the enforcement proceedings?

THE LAW & THE ARGUMENTS

The Judge initially dealt with issue (i), as to whether the Interim Account included some excluded operations under s105(2) of the Act.

The Judge started by explaining the law in his opening paragraph and noted that s104(5) states, in relation to a Construction Contract:

> *S104(5)*
> *where an agreement relates to construction operations and other matters, this Part applies only so far as it relates to construction operations.*[i]

Therefore, as the Judge stated, the Act expressly envisages that construction contracts may be hybrid in nature, in that they may include for undertaking both construction operations and operations which are excluded by s105(2) of the Act.

Accordingly, the relevant provisions of the Act will only apply to the part of the Contract which relates to construction operations.

S105(1) defines "construction operations" and as the Contractor had not yet broken ground on the Project, the Judge pointed out s105(1)(e) which states:

i S104(5) Housing Grants, Construction and Regeneration Act 1996 as amended by the Local Democracy, Economic Development and Construction Act 2009 ("The Act")

"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 … ; "

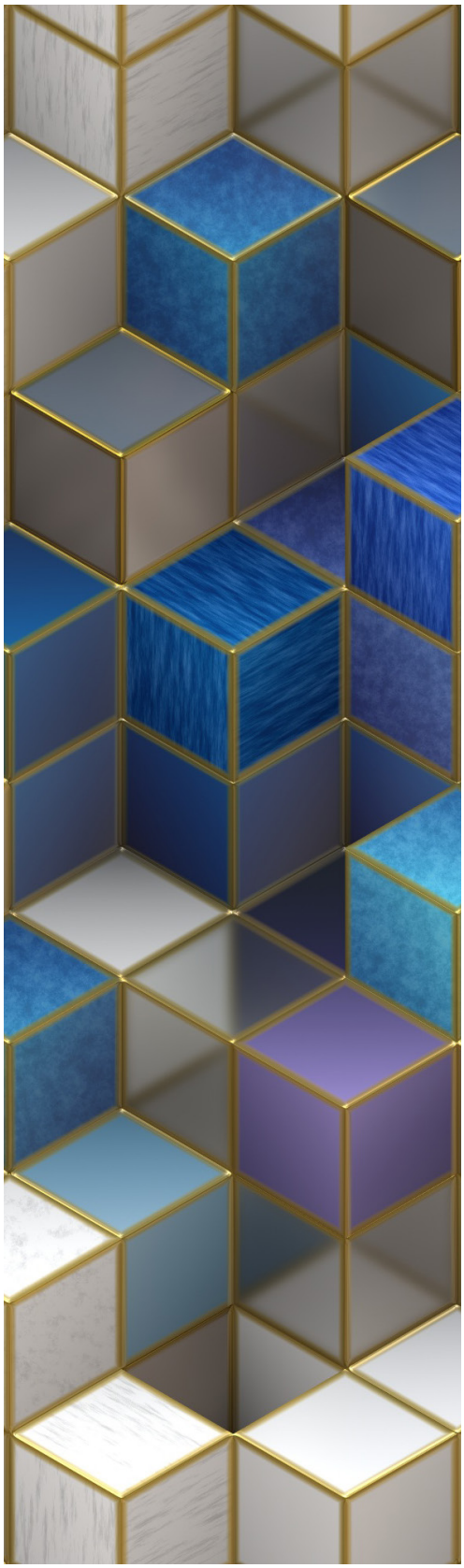
He went on to explain how S105(2) identifies operations which Parliament intended to be expressly excluded from the provisions of the Act, in particular s105(2)(c), which was the primary focus of the Contractor's argument, in that the Adjudicator did not have the jurisdiction to decide the dispute.

S105(2)(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-

nuclear processing, power generation …, [ii]

The Judge gave an obiter statement in relation to the exclusions, stating that:

"The reasons for this [exclusion] remain obscure. The distinction creates major practical difficulties for all of us involved in the implementation of the 1996 Act"



ii S105(2)(c) of the Act

The Judge considered recent authorities on this issue, namely; North Midland[iii] , Cleveland Bridge[iv] , Severfield [v] and Cantillon[vi] . While not all these cases were successful, they did seek to support hybrid Contracts and the complexity that the exclusions have imposed on adjudication. These cases narrowed the excluded operations described in s105(2)(c), as specific operations or tasks that can be distinguished from construction operations as described in s105(1), for the purpose of adjudication. It is the narrow identity of the operations that the Judge took from these cases, in that he was looking to distinguish the excluded operations rather than treat the contract as wholesale, as the Contractor had argued.

The Contractor argued that the contract contained some excluded operations. An example that the Contractor raised in its submissions was that the Interim Account contained sums for excluded operations, one of which and in particular, was a percentage of the overall contract sum, and therefore the Adjudicator did not have the jurisdiction to decide the dispute referred. The Contractor further submitted that the preparation of bonds and the business plan also constituted an element of excluded operations and distinguished these from items listed in s105(1)(e) which were items of physical work.

iii North Midland v A E & E Lentjes [2009] EWHC 1371 (TCC)

iv Cleveland Bridge (UK) Limited v Whessoe-Volker Stevin Joint Venture [2010] EWHC 1076 (TCC)

v Severfield (UK) Limited v Duro Felguera (UK) Limited [2015] EWHC 2975 (TCC)

vi Cantillon v Urvasco [2008] EWHC 282 (TCC)

The Employer's argument was simple, in that all the sums claimed were for the preparatory stages of the Project and no "excluded operations" had been undertaken, therefore the Adjudicator did have jurisdiction.

The question the Judge asked himself was "what was done by the Contractor and whether what was done amounted to excluded operations in accordance with s105(2)(c)?"

The Judge concluded this point by observing the fact that bonds, drawings and business plans are not physical site works, they are nonetheless preparatory works under s105(1)(e) and to treat these as excluded operations would make a nonsense of the Act. Furthermore, he said that it would be contrary to the aforementioned authorities in that, providing that something can be covered by the broad expression "construction operations", whether preparatory or ancillary, then the adjudication provisions shall apply and only when one can identify the operation in question to be a narrowly defined excluded operation, will the adjudication provisions be excluded.

Additionally, the Judge stated that as the Contractor had not yet broken ground, there was no question that any of the payments it had received, related to the narrowly defined excluded operations in s105(2).

It was therefore concluded that as the Judge had ruled in favour of the Employer on issue (i), issue (ii) became irrelevant. The Judge went on to consider issue (ii) in any event.

The Contractor argued that the letter sent in the first adjudication, challenging the jurisdiction of the Adjudicator, was never retracted and therefore covered the second adjudication also. The Judge rejected this argument, saying that each adjudication differs based on its own particular facts and attracts separate issues as to jurisdiction. With this in mind, should a Party

wish to challenge an Adjudicator's jurisdiction in one or more adjudication, it should do so in a clear and transparent way and for each separate adjudication to address the specific issues in which it desires to challenge.

COMMENTARY

The Employer was ultimately successful in these proceedings and was entitled to summary judgement in the full amount ordered by the Adjudicator.

The Judge concluded that no part of the dispute in the first or second adjudications related to operations excluded by s105(2) of the Act, and that the Adjudicators had the requisite jurisdiction to decide the dispute referred in each occasion.

In regard to the second issue, the Judge concluded that there was no general reservation of the Contractor's position on jurisdiction by way of its letter in the first adjudication, and that this letter was specific in nature and related only to the first adjudication only. Furthermore, if the letter could be considered as a general reservation of its position it was not raised again in the second adjudication.

One interesting point that came out of the background reading around "hybrid contracts" is "severability", which Cleveland Bridge, Severfield and Cantillon touched upon in obiter statements. Take, for example, a Party to a hybrid contract referring a dispute to an Adjudicator to decide the value of a particular payment notice. If that payment notice contains both s105(1) "construction operations" and s105(2) "excluded operations", then the Adjudicator has jurisdiction only to decide part of the dispute referred, and not the whole payment notice. This is what happened in Cleveland Bridge and Severfield. Ramsey J in Cleveland Bridge stated that since the Adjudicator decided the whole of the dispute referred, the decision could not be severed, and he could not enforce the decision.

Similarly, in Severfield Stuart-Smith J adopted the same approach and stated that it is not for the Court to adjust the award and sever the Adjudicators' decision and award only part of it, again the enforcement was refused[vii].

Stuart-Smith J also stated obiter:

"I fully accept that there may be cases (of which this may be one) where the 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…." [viii]

Stuart-Smith J further stated that this is not a reason for the court to bend what are the applicable principles of the Act[ix].

vii Ibid 5 at [25]

viii Ibid 5 at [26]

ix Ibid 5 at [26]

The main point to take from these cases is that, a Party to a dispute must be careful in how it refers its dispute and more importantly, is adjudication the correct vehicle for that dispute?

Many of the forms of contract that are hybrid in nature (in terms of operations) contain an array of dispute resolution procedures such as inter alia; adjudication, conciliation, expert determination and arbitration.

While adjudication is welcomed in the construction industry and as the Judges mentioned here have stated that it is "a blessing", the complications that Parliament have imposed with s105(2) of the Act upon hybrid contracts, mean that adjudication may not always be the best form of recourse and, as was seen in Severfield and Cleveland Bridge, it can often be fatal. Therefore, although some decisions in hybrid contracts may be enforceable, an aggrieved party must remember the approach of the courts in Severfield and Cleveland Bridge and must first consider the content of the dispute and carefully choose the correct vehicle for its resolution.

MORE INFORMATION

If you would like to find out more details about any of the subjects covered in this Ebriefing please contact DGA Group through the contact details below or at DGAGroup@dga-group.com

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