CONSTRUCTION FOCUS: ORAL CONTRACTS

Construction focus: The unwritten rule

Parties may be unaware that their works do not constitute construction operations for the purposes of the Construction Act 1996 and therefore incorrectly believe that the statutory provisions apply to their contract.

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> ***Parties may be unaware that their works do not constitute construction operations for the purposes of the Construction Act 1996 and therefore incorrectly believe that the statutory provisions apply to their contract.***

Written contracts are common in the construction industry due to the various standard form contracts available. However, we often come across contractors, developers and consultants who, for various reasons, have engaged in construction works without a written contract. Often this is due to simply not having sorted out the paperwork and other times it is due to an (occasionally misplaced) trust that the terms agreed verbally between the parties will be honoured. Another common occurrence is for a main contract to be in writing, with subsequent variations agreed orally.

A key difficulty with oral contracts and oral variations is that it is difficult to prove what has actually been agreed between the parties if there is a disagreement about the terms of the agreement. In addition to evidentiary problems, there are also some important considerations regarding the provisions of the Housing Grants, Construction and Regeneration Act 1996 ('the Construction Act') as amended by the Local Democracy, Economic Development and Construction Act 2009 (referred to herein as the Construction Act 1996).

Stephen Hirst and Mountain Developments Company Limited and others v Michael Paul Dunbar and others [2022] EWHC 41 (TCC)

The recent decision of the Technology and Construction Court in *Stephen Hirst and Mountain Developments Company Limited and others v Michael Paul Dunbar and others* [2022] is a useful reminder of what can go wrong if a written contract is not in place and encapsulates why lawyers like written contracts: because they ensure greater clarity.

In this case the contractor, Mr Hirst, sought payment for construction works carried out at a residential development on the basis of an agreement reached in a telephone conversation with Mr Dunbar. Mr Hirst claimed that the telephone conversation was an oral contract or a contract arising by conduct by his being engaged to undertake the works on the site and made a claim for payment based on his recollection of the phone call. There were no written components to the contract that the parties had entered into, and they seemingly relied instead on mutual trust, having been friends for many years.

A reminder of the key provisions of the Construction Act 1996

Adjudication: Section 108 gives parties the right to refer a dispute to adjudication and sets out certain minimum procedural requirements designed to:

- enable either party to a dispute to refer the matter to an independent adjudicator;
- limit the adjudication process to 28 days; and
- ensure a 'pay first, argue later' mechanism for resolving disputes and protecting cash-flow during construction projects, ensuring payments are made promptly.

Payment notices: Parties have the right to be informed of the amount due, or any amounts to be withheld. Construction contracts must provide that a payment notice is issued for every payment provided for by the contract. The sum contained in a payment notice is 'the notified sum'. The party who issues the notice is dictated by the contract, and can be either the payer, a 'specified person' as dictated by the contract (ie the contract administrator or architect), or by the payee itself. The notice must specify:

- the sum that the person giving the notice considers to be due or to have been due at the payment due date in respect of the payment; and
- the basis on which that sum is calculated.

Suspension for non-payment: If the employer fails to pay the amount due by the final date for payment and no effective pay less notice has been served, s112 of the Construction Act 1996 provides that the unpaid party may suspend the works and defines the timeframe for suspension and costs which it can recover.

The Scheme: If a construction contract does not include, in writing, all the adjudication provisions in ss108(2)–(4) of the Construction Act 1996, all of the adjudication provisions in Part I of the Scheme for Construction Contracts 1998 (referred to as the Scheme) are implied instead. The Scheme operates slightly differently for payment provisions. If the contract does not contain any payment rules, then all of the provisions within the Scheme will be implied as being a part of the contract, however if the contract is missing only certain payment provisions within the Scheme, then only the missing provisions will be implied as being a part of the contract. The provisions of the Scheme will also step in to replace any 'pay when paid' clauses. This type of clause makes payment conditional on payment being made by a third party under a separate contract (eg, a sub-contractor) and are prohibited by s113 of the Construction Act 1996.

Mr Dunbar said that Mr Hirst performed the works for his own benefit as he planned to then acquire the site. He argued that Mr Hirst was then unable to raise the funds required to purchase the site and so was unable to benefit from the works he had carried out.

The court, after a painstaking exercise of examining the factual evidence given, rejected the claim on the basis that there was no contract between the parties and agreed with Mr Dunbar that Mr Hirst had carried out the work at his own risk.

The case highlights the risks that parties take when they rely on an entirely oral contract. Eyre J stated that there was insufficient contemporaneous evidence to support either parties' claims which were considered vague and therefore neither of them could be considered reliable witnesses.

The Construction Act

Historically, parties only had the right to refer a dispute to adjudication if the contract was in writing and in accordance with s107 of the Construction Act 1996. This sets out the requirements that parties had to meet for their agreement to be considered as being in writing. The bar was not particularly high, and an agreement was seen to be in writing if:

- it was made in writing;
- it was made by an exchange of communications in writing;
- it was evidenced in writing; or
- it was an oral agreement which made reference to terms that were in writing.

However, the lack of clarity in the statutory provisions led to an excess of case law and overall the position was uncertain. Section 107 was repealed in 2009 (by s139 of the Local Democracy, Economic Development and Construction Act 2009) and the Construction Act 1996 began to apply to unwritten contracts.

Although the Construction Act 1996 has for some time applied to unwritten contracts, it is important to remember that it does not apply to all contracts used in the construction industry, and in certain instances if a party wishes to rely on the right to adjudicate, or on certain payment provisions, this must be set out in a written contract.

Construction operations

The Construction Act 1996 defines a construction contract as a contract 'for the carrying out of construction operations'. The term 'construction operations' is used by the Construction Act 1996 in a broad sense and includes a wide range of construction and engineering operations, although some engineering projects are expressly excluded by the Act and it is here where confusion can arise.

Excluded operations include:

- drilling for, or the extraction of, oil and natural gas;
- extraction, tunnelling or boring of minerals;
- assembly, installation or demolition of plant or machinery, or the erection or demolition of steelwork for the purposes of supporting or providing access to plant or machinery (this is where the primary activity on site is nuclear processing, power generation or the production of chemicals, pharmaceuticals, oil, gas, steel, food or drink);
- manufacture or delivery to site of certain components, materials, plant or machinery;
- making, installing and repairing of artistic works (such as sculptures).

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Residential occupiers

Section 106(1) of the Construction Act 1996 is not applicable to contracts with residential occupiers. It states that:

> *… a construction contract with a residential occupier means a construction contract which principally relates to operations on a dwelling which one of the parties to the contract occupies, or intends to occupy, as his residence.*

Therefore, parties involved in projects for residential occupiers are unable to rely on the statutory implied terms regarding payment and adjudication.
This is not always clean cut, as demonstrated by the case of *Westfields Construction Ltd v Lewis* [2013]. Here, Mr Lewis argued that the adjudicator did not have the jurisdiction to decide the dispute between himself and Westfields, the contractor, because the contract concerned a house which, at the time of the contract, he said he occupied as his residence and intended to occupy in the future.

The judge rejected Mr Lewis' argument that he was a 'residential occupier', ruling that it is the intention at the time of the formation of the contract that is important. Mr Lewis' intention was to let the property when the works completed, and this was made known to the contractor at the time the contract was entered into. Therefore, Mr Lewis could not be said to have an intention to occupy for the purposes of the Construction Act 1996.

Although this case does not touch on oral contracts, it illustrates that it is not always clear whether the provisions of the Construction Act 1996 will apply. Previous decisions have also confirmed that the s106(2) exclusion is not applicable in instances where there is a commercial element to the purpose of the works, or where the works are carried out on other buildings within the grounds of a main residence which are not occupied.

The simple way to avoid any potentially expensive and time-consuming arguments about the nature of the operations, or whether an employer should be considered a residential occupier, is to agree and sign a written contract at the outset which contains payment provisions and an adjudication clause.

Variations

Before s107 of the Construction Act 1996 was abolished, difficulties arose as case law developed that if a contract was in part unwritten or oral, it was unlikely to be upheld and an adjudicator's decision would not be enforced. Following the repeal of s107, the provisions of the Construction Act 1996 apply to oral, or part oral part written, contracts.

This change was particularly impactful in situations where letters of intent have been signed but not a subsequent building contract, and where contracts are based on standard terms and conditions supplemented by oral agreements. Since the abolition of s107, the

Construction Act 1996 can now be applicable to written contracts and any verbal amendments.

The change received a mixed reception – it appeared to solve some problems but create others. In *RCS Contractors Ltd v Conway* [2017], the TCC expressed regret that s107 of the Construction Act 1996 was 'unthinkingly repealed' and the right to adjudicate was no longer limited to written contracts. The court highlighted the difficulty for adjudicators in deciding on oral contracts and the fact that disputed oral contracts are unlikely to be subject to successful summary enforcement.

To minimise the risk of uncertainty with verbal variations generally, parties should consider including an entire agreement clause (see box below) in their contracts to ensure that the agreement is limited to the contents of the signed document. Although an entire agreement clause cannot prevent discussions on the existence of oral agreements, it is a useful aid for the party arguing against the existence of the oral agreement.

Entire agreement clauses

An entire agreement clause, also known as a whole agreement clause, is a contractual provision which aims to prevent the party relying on it from being liable for any statements or representations (including pre-contractual representations) except as expressly set out in the agreement.

Oral variations

Parties often try to limit variations to a contract to those made expressly in writing; however, the case of *ZVI Construction Co LLC v Notre Dame University (USA)* [2016] demonstrates that this is not always sufficient to prevent the contract from being varied orally. Here, the court held that a development agreement could be orally varied, notwithstanding the inclusion of a clause which expressly stated that any effective modification, alteration or waiver of its provisions must be:

> *… in writing and signed by or on behalf of the party against which the enforcement of such modification, alteration or waiver is sought.*

Despite there being no written signed record of a variation in accordance with the contract, it was held that the parties had undone the clause's limitations. The court relied on two earlier authorities (*Globe Motors Inc v TRW Lucas Varity Electric Steering Limited* [2016] and *Rock Advertising Ltd v MWB Business Exchange Centres Ltd* [2016]/[2018]) and held that there was nothing to prevent parties from agreeing to vary a contract orally, notwithstanding the fact that they had previously agreed to an 'in writing only' clause.

The court had to determine:

> *… whether, by their actions, words or conduct they [the parties] must be taken to have intended to modify or alter or waive a term of the Development Agreement, bearing in mind that they agreed to the terms of clause 24 in the first place.*

In this case, it was held that the parties could and did agree to vary the terms of the contract otherwise than in accordance with its clause 24.

Nonetheless, it is still good practice to include such 'in writing only' clauses as this case, as this case appears to turn on the specific facts rather than creating a general rule.

Conclusion

In clearly setting out and agreeing the contractual terms at the beginning of a contractual relationship, parties to a construction contract can effectively protect themselves as far as is possible against the headache of having to retrospectively attempt to persuade a court of what they claim was agreed with the other party to a dispute. It is also the most effective way to ensure that you will have the right to adjudicate and the benefit of protection from payment provisions. Oral contracts, more often than not, cause ambiguity and can lead to expensive and time-consuming disputes that could have been easily avoided by the existence of a clear written contract.

Cases Referenced

- Globe Motors Inc v TRW Lucas Varity Electric Steering Limited [2016] EWCA Civ 396
- RCS Contractors Ltd v Conway [2017] EWHC 715 (TCC)
- Rock Advertising Ltd v MWB Business Exchange Centres Ltd [2016] EWCA Civ 553; [2018] UKSC 24
- Stephen Hirst and Mountain Developments Company Limited and others v Michael Paul Dunbar and others [2022] EWHC 41 (TCC)
- Westfields Construction Ltd v Lewis [2013] EWHC 376 (TCC)
- ZVI Construction Co LLC v Notre Dame University (USA) [2016] EWHC 1924

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