

PAYMENT PROVISIONS IN CONSTRUCTION CONTRACTS: WHEN AND WHAT TO IMPLY FROM THE SCHEME

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A RECENT CASE ABOUT THE CONSTRUCTION OF A NEW HOTEL USING MODULAR METHODS HAS PROVIDED IMPORTANT GUIDANCE ON HOW PAYMENT ARRANGEMENTS IN CONSTRUCTION CONTRACTS OPERATE IN PRACTICE.

In *Bennett (Construction) Ltd v CIMC MBS Ltd (formerly Verbus Systems Ltd)*[i], the English Court of Appeal held that a construction contract providing for milestone payments to be made on “sign-off” contained an adequate payment mechanism compliant with the Construction Act 1996[ii].

The Court also provided useful guidance on the operation of default payment arrangements that would have been implied into the contract under the Scheme for Construction Contracts[iii] had the parties’ agreed payment arrangements not complied with the statutory requirements.

The decision is to be welcomed given the scarcity of authority on the topic, providing clarity on how default payment terms under the Scheme apply to non-compliant construction contracts.

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BACKGROUND

Bennett (Construction) Limited (“Bennett”) had subcontracted to CIMC MBS Limited (formerly Verbus Systems Limited) (“Verbus”) the design, supply and installation of pre-fabricated modular bedroom units to be made in China and shipped to Southampton for installation in a hotel to be constructed in East London. This method of construction is increasingly popular as it minimises the amount of construction time on site.

The contract incorporated certain terms from the Joint Contracts Tribunal (“JCT”) 2016 standard form of contract, but the usual terms relating to interim payments were deleted in their entirety and replaced by “revised terms” providing for five milestone payments. Milestones 2, 3 and 4 provided for payments on “sign-off” of a prototype room, snagging items, and completed units on delivery in Southampton (respectively). However, “sign-off” was undefined in the contract. Verbus produced the prototype room but Bennett argued it did not comply with the contract and alleged that there were numerous defects. Verbus disagreed and went on to produce the remaining modular units, none of which were ever signed off. This resulted in a dispute over the meaning of “sign-off”, upon which payment of milestones 2, 3 and 4 was contingent.

At first instance, the Technology and Construction Court (TCC) agreed with Verbus in respect of the requirement for “sign-off” of milestones 2 and 3 but not in respect of milestone 4, which was held to be compliant. This resulted in the TCC concluding that it was impossible to only alter milestones 2 and 3, and “for reasons of workability and coherence” the only approach was to replace milestones 2 to 5 with paragraphs 2, 4 and 5 of Part II of the Scheme. This resulted in a liability for Bennett to make interim payments calculated by reference to the value of the work done, regardless of whether any milestone had been reached. Bennett appealed.

THE LEGAL FRAMEWORK

The Construction Act 1996 sets out mandatory payment provisions which every construction contract must comply with. Should a construction contract fail to be Act-compliant, the provisions of the Scheme automatically apply as implied terms within the contract and replace its infringing terms.

In particular:

- Section 109 of the Act (Entitlement to stage payments) provides that a party to a construction contract is entitled to payment by instalments, stage payments or other period payments unless the duration of the work is to be less than 45 days. In the absence of such an agreement, the relevant provisions of Part II of the Scheme will apply (considered below); and
- Section 110 of the Act (Dates for payment) provides that the contract must provide an adequate mechanism for determining what payments become due and when, and provide a final date for payment for any sum which becomes due. Again, if there is no adequate mechanism in the contract, the Scheme provides that interim payments become due seven days after the end of each relevant period (Part II, paragraph 4) and the final payment becomes due 30 days after completion (Part II, paragraph 5). The final date for payment is set at 17 days after the sum became due (Part II, paragraph 8).

COMPLIANCE WITH THE CONSTRUCTION ACT 1996

The Court of Appeal held that the contract contained an adequate payment mechanism, notwithstanding the requirement for (undefined) “sign-off” in milestones 2 and 3.

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- As a matter of construction, “sign-off” was to be interpreted *objectively*, by reference to when the relevant stage was complete (for example, when the prototype or the units were complete in accordance with the contract and in a condition in which they could effectively be signed off). Nothing in the contract linked “sign-off” to the production of a certificate or a record of any sort – if actual “sign-off” was required as a condition precedent to payment, the contract would have said so.
- However, even if a *subjective* interpretation had been intended and a sign-off document was required, if the prototype was in a state to be signed-off Bennett could not avoid their liability to pay milestone 2 by taking “advantage of the non-fulfilment of a condition the performance of which has been hindered by himself”. This, therefore, was not a case where the potential involvement of third parties in the process would invalidate the payment regime.

The Court also rejected the suggestion that the absence of an express due date or final date for payment in the contract following “sign-off” resulted in non-compliance with the Construction Act 1996. Instead, the Court suggested that such details were not necessary in a contract of this type (“the sum was payable when the completion was achieved”) and stressed that the parties were expected to adopt business common sense as to arrangements for invoicing and payment.

PART II OF THE SCHEME

Nevertheless, on an *obiter* basis, the Court went on to consider which provisions of the Scheme would have been implied into the contract if milestones 2 and 3 had not complied with the Construction Act 1996.

Emphasising the difference between Part I of the Scheme (relating to adjudication) and Part II (dealing with payments provisions), the Court noted that whilst Part I will apply in its entirety (or “lock, stock and barrel”[v]) when the contract does not contain proper adjudication provisions, Part II is to be incorporated into a contract only to the extent necessary to achieve what is required by the Construction Act 1996[vi]. Despite referring to this solution as settled law, the Court noted that leading counsel were unable to find any authority dealing with “the interplay between an inadequate mechanism for periodic and interim payments, and paragraphs 1-7 of Part II of the Scheme”.

Describing Part II of the Scheme as “badly drafted”, the Court considered that it was possible to pilot a course through its provisions in order to achieve a common-sense result that, when applied, avoids any significant violence to the parties’ original agreement. The Court went on to dissect Part II of the Scheme, noting that:

- Paragraphs 1 and 2 of Part II deal with the problem identified by section 109 of the Construction Act 1996; and
- Paragraphs 3 and onwards of Part II concern section 110 of the Construction Act 1996, with paragraphs 4 to 7 identifying different kinds of payment.

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The Court determined that milestone payments 2 and 3 did not constitute final payments or payments under an exempted contract and, as such, paragraphs 5 and 6 would not be relevant. Similarly, the milestone payments were not the “kind of payment mentioned in paragraph 2” (i.e. payments based on “the value of any work performed”), meaning that paragraph 4 would not be relevant. Accordingly, by a process of elimination, the Court concluded that, had milestones 2 and 3 been non-compliant, only paragraph 7 of Part II of the Scheme should have been implied.

Referring to paragraph 7 as a “catch-all” provision, the Court noted that this was the only provision concerning “other payments” which was not based on “the value of any work performed” – unlike paragraphs 2 and 4 of the Scheme. Had it been implied for milestones 2 and 3, it would have given the parties a due date of seven days for payment from the completion of the prototype and the units in accordance with the contract (respectively) whilst not amending milestones 1, 4 or 5 or imposing on the parties’ payments by interim valuations, thereby doing “the least violence” to their agreement.

CONCLUSION

This decision clarifies the requirements of the Construction Act 1996 in relation to payment provisions in a construction contract and provides invaluable guidance as to how Part II of the Scheme is to operate should the contract be non-compliant. Importantly, the decision also makes it clear that, where the application of the Scheme cannot be avoided, its provisions should be implied into the infringing contract only to the extent necessary to render it compliant with the Construction Act 1996. In addition, this decision reinforces that parties should take care when drafting and negotiating contracts and/or amending standard contract forms to ensure that their agreed contractual payment regimes are not amended by the court in order to comply with the corresponding requirements in the Construction Act 1996.

Mathieu Quenin also contributed to this article.

[i] [2019] EWCA Civ 1515

[ii] The Housing Grants, Construction and Regeneration Act 1996, as amended (the Construction Act 1996)

[iii] The Scheme for Construction Contracts (England and Wales) Regulations 1998 (SI 1998/649), as amended (the Scheme)

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[iv] *Roberts v Bury Improvement Commissioners* (1870) LR 5 CP 310 and *Waddan Hotel Limited v MAN Enterprise SAL (Offshore)* [2015] BLR 478

[v] *Yuanda (UK) Co Ltd v WW Gear Construction Ltd* [2010] BLR 435

[vi] See *Banner Holdings Limited v Colchester Borough Council* [2010] EWHC 139 (TCC); [2010] 131 Con LR 77 and *Grove Developments Ltd v Balfour Beatty Regional Construction Ltd* [2016] EWHC 168 (TCC)

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