

Construction Law Update

Is Requiring “sign-off” Before Payment Permissible?

The Housing Grants, Construction and Regeneration Act 1996, as amended (the “Act”) requires that all construction contracts contain a compliant regime of interim and final payments. In the recent case of *Bennett (Construction) Limited (“Bennett”) v CIMC MBS Limited (formerly Verbus Systems Limited) (“Verbus”)* the Court of Appeal considered whether milestone payments which were to be made on “sign-off” of a particular stage of works were compatible with the requirements of the Act.

Background

Bennett was the main contractor for the construction of a new hotel and engaged Verbus to design, supply and install 78 prefabricated bedrooms which would be made in China and then shipped to Southampton. The contract provided for milestone payments to be made on “sign-off” of a prototype room and “sign-off” of all snagging items in China.

Verbus produced a prototype room which Bennett said did not comply with the contract. Despite this, Verbus produced the other 78 rooms in China which Bennett also said did not comply with the contract. Accordingly, there was no “sign-off” of either the prototype or actual rooms. The contract came to an end when the developer entered into liquidation.

Did the payment provisions comply with the Act?

At first instance, it was held that there was no adequate mechanism for determining what payments became due and when as required by s110(1)(a) of the Act. Paragraphs 2, 4 and 5 of Part II of the Scheme for Construction Contracts (England and Wales) Regulations 1998 (the “Scheme”) were incorporated in place of the milestone payments which resulted in Bennett having to make payments by reference to value of the work which Verbus had carried out regardless of whether the milestones had been achieved.

However, the Court of Appeal reversed this decision. Coulson LJ concluded that the term “sign-off” had to be construed objectively, such that on completion of the relevant stage the milestone would be paid. It did not mean that payment was conditional upon a certificate or record signed by Bennett but, even if it did, Bennett would not have been able to rely on its own failure to issue a certificate to avoid payment and Verbus would have been entitled to payment on completion of the relevant stage. “Sign-off” was, therefore, shorthand for the objective state which the prototype and units had to reach before payment was due and the milestone became payable on the date that was achieved.

What provisions would have been incorporated?

Despite finding that the payment provisions were compliant, the Court of Appeal considered what provisions of the Scheme should have applied if they were not. Coulson LJ regarded it as settled law that, where payment provisions do not comply with the Act, Part II of the Scheme applies only to such extent as is necessary and is not incorporated into the contract wholesale.

He concluded that the milestone payments were not within paragraph 2 of the Scheme as they were based on the completion of a stage of works and not on the value of any work performed. Accordingly, paragraph 7 of the Scheme was the only provision which could apply and would have provided that payment would become due on the expiry of 7 days following the completion of the work to which the payment related. Coulson LJ stated that this replacement would have done the least violence to the original agreement between the parties.

Analysis

Coulson LJ stated that the purpose of the Act was to provide certain minimum standards to achieve certainty and regular cash flow. In this case, had the provisions of the Scheme been incorporated

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wholesale, it would have completely changed the agreement of the parties and significantly altered the assignment of commercial risks. Coulson LJ made clear that this was not the purpose of the Act and that the agreement of the parties should be respected. However, this case should serve as a stark warning of potentially significant ramifications of failing to define terms within payment provisions and ensuring that they are compliant with the Act from the outset.

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