

Milestone payments and the Construction Act: Court of Appeal guidance

United Kingdom · 09.09.2019

A Court of Appeal decision published last week has considered the interplay between milestone payments agreed between the parties and the requirements of the Construction Act as to an adequate payment mechanism. The decision sets a reasonably low bar in this regard and also resolves the correct approach to be taken when implying payment terms from the Scheme for Construction Contracts to remedy non-compliances. The Court has made clear that only in the rarest of cases will it be necessary for contract provisions as to payment to be substituted entirely for those in the Scheme.

Sections 109 and 110 of the Construction Act

Section 109 of the Housing Grants Construction and Regeneration Act 1998 (the “Construction Act”) provides an entitlement for a party to a construction contract to be paid “by instalments, stage payments or other periodic payments for any work under the contract”. If the parties fail to agree the amounts of such payments, the intervals at which or the circumstances in which they fall due, the Scheme for Construction Contracts (the “Scheme”) applies to imply certain default payment provisions into the contract.

Section 110 supplements s109 by requiring an “adequate mechanism” for determining “what payments become due under the contract, and when” as well as providing for a final date for payment in relation to any sum which becomes due. Failure to do so again results in the Scheme applying.

Previous cases have held that the Scheme provisions as to payment apply only insofar as is needed to address non-compliance with the Construction Act (as opposed to the Scheme’s adjudication provisions which apply in full where required). However, it has been unclear how the court is to go about piecing together the Scheme’s payment provisions with any parts of the agreed payment provisions which are compliant with the Construction Act. This tension is particularly apparent in relation to milestone payments, as the Scheme only includes provisions for periodic payment by way of interim valuations, not by milestones.

Bennett (Construction) Ltd v CMC MBS Ltd (formerly Verbus)

Bennett was the main contractor in respect of a proposed new hotel in London. Bennett contracted to Verbus the design, supply and installation of prefabricated modular bedroom units for the hotel.

The contract incorporated the standard form JCT contract but replaced the standard interim valuation payments with five milestone payments, three of which referred to a requirement for “sign-off”, although the term of “sign-off” was not specifically defined in the contract.

Verbus produced a prototype of the bedroom unit to be used, which Bennett said did not comply with the contract terms. Despite this rejection, Verbus went on to produce all of the bedroom units. A dispute as to payment arose, with Bennett relying on the absence of “sign-off” and Verbus complaining that such a requirement did not comply with the requirements of the Construction Act.

The TCC agreed with Verbus that two of the milestones (numbers 2 and 3) did not comply with the requirements of the Construction Act because they required “sign off” by Bennett and could therefore be withheld at Bennett’s discretion. Another milestone also referred to “sign off” but did not say who by and was to be interpreted as simply referring to completion of the relevant stage. As the Scheme did not specifically address milestone payments, the judge considered that the interim valuation provisions of the Scheme should be incorporated in their entirety to replace all of the milestones under the contract (except for an initial deposit). That was because replacing only two of the milestones with interim valuations would leave the remaining milestones in an uncertain and unworkable state. The result was that the parties’ intention for milestone payments had been entirely changed to payment by interim valuations.

The TCC’s decision entitled Verbus to payment regardless of the state of completion of the bedroom units. Bennett appealed both as to whether milestones 2 and 3 complied with the Construction Act and, if not, the extent to which the Scheme should apply.

Construction Act compliant?

The Court of Appeal disagreed that the references to “sign off” in milestones 2 and 3 allowed Bennett a discretion as to certifying payment. The issue was one of interpretation and the Court placed particular emphasis on the fact that “sign off” was not linked to the production of a certificate or record of any sort, nor was any record of “sign off” expressed to be a condition precedent to payment: *“if actual sign-off was required, the contract would have said so”*. Instead, the phrase “sign-off” denoted an objective state of completion that the relevant units had to reach before payment was due.

The Court also found that a requirement for actual “sign-off” would not have made any meaningful difference to the operation of the payment provisions. If the units were otherwise complete, Bennett could not refuse to allow “sign-off” and *“take advantage of the non-fulfilment of a condition the performance of which has been hindered by himself”* (quoted from *Roberts v Bury Commissioners*).

Also of note, the Court did not consider that the failure to specify a due date and a final date for payment contravened the Construction Act. Lord Justice Coulson did, *“not consider that such details were necessary in a contract of this type. Parties are always free to agree interim payments by reference to percentages of completion. Thereafter, the courts expect the parties to adopt business common sense as to the arrangements for invoicing and payment.”*

The Scheme payment provisions

Although not strictly necessary in light of the above findings, the Court proceeded to consider the issues arising under Scheme due to their wider importance to the industry. The Court noted that the effect of the TCC’s approach had created *“a significant reapportioning of the commercial risk which the parties had agreed”*.

The Court commented that, whilst it was settled law that the payment provisions of the Scheme were only to be implied insofar as necessary to remedy any non-compliance with the Construction Act, there was very little authority on how the court should go about that task. Noting that the Scheme was *“badly drafted”*, the Court nonetheless considered it was possible to pilot a course through the provisions in order to achieve *“a common sense result that ... does no significant violence to the parties’ original agreement”*. An approach which does the least violence to the parties’ intention *“should be central to the court’s considerations.”*

In the present case, the Court considered that the TCC was wrong to replace non-compliant milestone provisions with the interim valuation provisions set out in paragraph 2 of the Scheme. Instead those provisions should be made to work by using paragraph 7 of the Scheme which refers to *“any other payment under a construction contract”* and stipulates a due date 7 days *“following the completion of the work to which the payment relates”*.

Conclusion and Implications

This is an important decision of the Court of Appeal clarifying the correct approach to implying the Scheme provisions as to payment where the payment provisions of a construction contract do not satisfy the requirements of the Construction Act. Only in the rarest of cases will the contract provisions be replaced wholesale. Instead, the contractual payment mechanism will be preserved to the extent possible, and only deficient provisions of the payment regime should be replaced.

This clarification is of particular importance for milestone payments, given the approach initially adopted by the TCC in this case of imposing the Scheme’s provisions for interim valuations in place of the parties’ agreed milestones.

The Court’s findings as to the “sign off” requirement, although understandable on the facts of the present case, may give rise to further argument in other cases. The finding that “sign off” meant merely completion of the bedroom units was reached despite specific language stating that “sign off” was to be by Bennett and/or its agents. The Court’s finding that the milestone payment would fall due upon completion of the units, even if actual “sign off” were required (because Bennett would not be unable to withhold “sign off”) leaves unclear whether Bennett would have had a reasonable period after completion for sign off to take place. The finding that a milestone payment provision is compliant without specifically expressing a due date and final date for payment might also be contrasted with section 110 of the Construction Act which appears to envisage two separate dates.

References:

[Bennett \(Construction\) Limited v CIMC MBS Limited \(formerly Verbus Systems Ltd\)](#) [2019] EWCA Civ 1515.

[Roberts v Bury Commissioners](#) [1870] LR5CP 310.

KEY CONTACTS



Anne Thompson

Associate, Sheffield

+44 114 279 4167

Anne.Thompson@cms-cmno.com



Aileen Brown

Senior Associate, London

+44 20 7367 2486