Neutral Citation Number: [2019] EWCA Civ 1515

Case No: A1/2018/2393/QBENF

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
TECHNOLOGY AND CONSTRUCTION COURT
HIS HONOUR JUDGE WAKSMAN QC

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 30th August 2019

Before:

LORD JUSTICE LONGMORE
LORD JUSTICE COULSON
and
MR JUSTICE SNOWDEN

- -

Between:

BENNETT (CONSTRUCTION) LIMITED	**Appellant**
- and -	
CIMC MBS LIMITED (formerly Verbus Systems Ltd)	**Respondent**

- -
- -

Ms Chantal-Aimee Doerries QC and Mr David Johnson
(instructed by **Brecher LLP**) for the **Appellant**
Mr David Sears QC (instructed by **Fladgate LLP**) for the **Respondent**

Hearing Date: 11th July 2019

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APPROVED JUDGMENT

Lord Justice Coulson :

1 INTRODUCTION

1. The Housing Grants, Construction and Regeneration Act 1996, as amended by the Local Democracy, Economic Development and Construction Act 2009 ("the Act") was designed to address the perceived ills of the construction industry in the 1980's and 1990's: the failure of larger companies to pay smaller ones on time or at all, and the absence of a quick and inexpensive means of dispute resolution. The Act contains mandatory provisions setting out what all construction contracts must contain relating to i) the resolution of disputes by way of adjudication, and ii) a regime of interim and final payments. If the contract in question does not contain proper provisions in these two respects, the Act will – subject to certain qualifications - impose its own terms.

2. The present appeal arises out of the interplay between the contract terms agreed between the parties and the requirements in the Act as to an adequate payment mechanism. Two particular issues arise. The first is whether a regime requiring payment of a percentage of the contract sum on "sign-off" of a particular stage of the works complies with the Act; the second, if it does not, concerns the mechanism by which the Act (and the Scheme for Construction Contracts, which it introduced) is incorporated into the contract in order to 'save' the bargain which the parties made.

2 THE CONTRACT

3. The in the present case was dated 1 June 2012. It related to a proposed new hotel at Woolwich, in East London. The developer was Key Homes. The eventual operator of the hotel was Park Inn. The main contractor was the appellant, Bennett (Construction) Limited ("Bennett"). Bennett contracted to CIMC MBS Limited (formerly Verbus Systems Limited) ("Verbus") the design, supply and installation of 78 prefabricated modular bedroom units for the hotel. The units were to be made in China and then shipped to Southampton. The contract price was just over £2 million.

4. Some of the contractual terms incorporated the standard form JCT contract. However, the detailed arrangements of the JCT standard form dealing with interim payments were deleted in their entirety and replaced by what were called "revised terms" as to payment. There were five such payments, which the parties have called 'Milestones'. I have indicated each below, followed by their description in the contract:

> Milestone 1. "20% deposit payable on execution of contract;"
>
> Milestone 2. "30% on sign-off of prototype room by Park Inn/Key Homes/Bennett in China;"
>
> Milestone 3. "30% on sign-off of all snagging items by Park Inn/Key Homes/Bennett in China;"
>
> Milestone 4. "10% on sign-off of units in Southampton;"
>
> Milestone 5. "10% on completion of installation and any snagging".

5. Given that the concept of "sign-off" was so central to Verbus' challenge to the validity of Milestones 2, 3 and 4, it is important to see how it was addressed in the contract. There was no specific definition of the term. The references set out in the first judgment of Judge Waksman QC (as he then was) were gleaned from the detailed proposals provided by Verbus, which were referred to as 'the contract specification'.

6. At page 118 of the appeal bundle, having set out in detail the particular type and specification of materials to be used in the construction of the room modules, the specification goes on:

> "The module construction mechanical and electrical installation and internal fit-out will be to UK standards. This includes pipe sizing and electrical cable. Our [Verbus'] British project manager will be present in the factory to oversee the fit-out of modules and will invite the client to the factory to inspect and sign off the modules before shipping to ensure suitability. The mechanical and electrical work will be overseen and certified by British certified tradesmen in our factory."

7. The other references to sign-off referred to by the judge were as follows:

   a) The specification on page 119 said:

   "During this period, once all the modules are completed, a client representative will be required to attend the factory to review and sign off the modules prior to shipping".

   b) It went on:

   "The modules will be fitted out prior to delivery on site. The fit out will be to the client's specification, final details of which need to be supplied to [Verbus] by [Bennett] at the time of the order, particularly details of the scope of the fit out required in the factory. The fit-out will overseen by our UK project manager who will be based in China for the duration of the works and sign off the modules prior to departure from the factory. A clients representative will also be required in China once the modules are completed to snag and sign off the units prior to shipping".

8. Verbus' proposals also included a section about previous hotel projects on which they had worked. About the Premier Inn in Hull, they said:

> "Whenever we work for a new operator, we invite their team to our factory to meet the team, inspect our facilities and sign off a prototype module in advance of full manufacture to ensure their complete satisfaction."

9. There were a number of other references to "sign off" to which the judge did not refer. They were contained in the contract documents themselves (which were put together by the parties in a somewhat ramshackle way), as opposed to the standard JCT terms (for which 'sign-off' is an unknown concept). There is a reference to the

storage and security of on-site materials which it was said would be subject to a "verbal sign off on site" (see the minutes of the Pre-Award Meeting). A different set of Pre-Award Meeting notes also talked about "inspection procedures and sign offs".

3 THE FACTUAL BACKGROUND

10. Verbus produced a prototype of the unit in China but Bennett said that it did not comply with the contract. Despite that dispute, Verbus went on to produce the 78 bedroom units in China. Before they left the factory, there was also a dispute as to whether or not these units complied with the contract. Bennett alleged that there were numerous defects. In consequence, there was no actual sign-off of either the prototype or the units themselves, nor any agreement that the prototype or the units had ever reached a stage of completion in which they could have been signed off. Subsequently, some 'without prejudice' payments were made to Verbus and some of the units were shipped to the UK at their own risk. In the end the whole contract came to an end following the liquidation of Key Homes. Ms Doerries QC told the court that the units have since been scrapped.

11. There was an adjudication about the validity of the Milestone payments which led to a decision in Bennett's favour. Verbus continued to complain that the Milestones, or at least Milestones 2, 3 and 4, did not comply with the requirements of the Act. In a judgment dated 18 July 2018 ([2018] EWHC 2440 (TCC)) ("the first judgment"), Judge Waksman agreed with that proposition in respect of Milestones 2 and 3, although not Milestone 4. He allowed the parties time to work out by agreement a replacement payment schedule but they were unable to do so. Accordingly, following the exchange of written submissions, in a judgment dated 22 August 2018 ([2018] EWHC 2222 (TCC)) ("the second judgment"), he concluded that it was impossible to alter just Milestones 2 and 3 and that "for reasons of workability and coherence the only approach on the facts of this case was to incorporate Paragraphs 2, 4 and 5 of Part II of the Scheme for Construction Contracts to supplant Milestones 2-5 as a whole." His incorporation of particular paragraphs of Part II of the Scheme resulted in a liability on the part of Bennett to make interim payments calculated by reference to the *value* of the work which Verbus had carried out. Bennett now appeal against both elements of the judge's conclusions.

12. The commercial effect of the judge's decisions is stark. Prior to these proceedings, the principal dispute between the parties concerned whether or not the prototype and the units had been completed (i.e. were in a condition in which they could have been signed off as complete). Verbus said they had; Bennett said they had not. On Bennett's construction of the contract, until that dispute was resolved, Verbus were not entitled to payment of Milestones 2, 3 or 4, or any part thereof. But, in consequence of the judge's two judgments, Verbus became entitled to interim payments by reference to the value of the work which they had carried out. In this way, Verbus would become entitled to payment, regardless of whether or not the prototype or the units themselves had reached a stage of completion at which they could have been signed off.

13. So by way of example, under the regime imposed by the judge, if Verbus could show that, in respect of Milestone 3, all that remained outstanding in respect of the 78 units were snagging items which were more than *de minimis* but capable of quantification at, say, 10% of the contract sum, they would have to accept that they had not achieved

a condition in which the units could have been signed off as complete under the contract, but would still be entitled to 20% of the contract sum (the 30% identified in the contract, less the 10% referable to outstanding items) by way of an interim payment.

14. It seems to me that that is a significant reapportioning of the commercial risk which the parties had agreed. I consider that it would take very clear words in the Act in order to bring that about. However, in his careful submissions on behalf of Verbus, Mr Sears QC maintained that that indeed was the effect of the Act, and the Scheme for Construction Contracts which it introduced.

4 ISSUE 1: DID MILESTONES 2 AND 3 COMPLY WITH THE CONTRACT?

4.1 Overview

15. Section 110 of the Act requires every construction contract to contain "an adequate mechanism for determining what payments become due under the contract and when". Verbus contend (and the judge agreed) that the 'sign-off' requirement envisaged an actual signing off of the works, and that due payment could be circumvented by a deliberate decision not to sign off or prevent others from signing off the prototype or the units. Verbus also argued that the contract offered no clear criteria for sign-off, because it envisaged the involvement of third parties (such as 'the client') with no status under the contract at all. For these principal reasons, they maintained that Milestones 2 and 3 did not comply with the Act.

16. On behalf of Bennett, Ms Doerries contended that 'sign-off' meant simply the date on which completion of the identified stage of the work (the prototype for Milestone 2 and the units in China for Milestone 3) was achieved (and so was capable of being 'signed-off'). She said that, accordingly, the trigger for payment was clear: it was when the relevant work was completed in accordance with the contractual requirements. There was no confusion as to criteria: Verbus simply had to comply with the contract specification. On that analysis, Bennett said that Milestones 2 and 3 complied with the Act.

4.2 The Statutory Framework

17. Sections 109 and 110 of the Act provide as follows:

> **109.— Entitlement to stage payments.**
> (1) A party to a construction contract is entitled to payment by instalments, stage payments or other
> periodic payments for any work under the contract unless—
> (a) it is specified in the contract that the duration of the work is to be less than 45 days, or
> (b) it is agreed between the parties that the duration of the work is estimated to be less than
> 45 days.
> (2) The parties are free to agree the amounts of the payments and the intervals at which, or
> circumstances in which, they become due.

> (3) In the absence of such agreement, the relevant provisions of the Scheme for Construction Contracts apply…
>
> **110.— Dates for payment.**
> (1) Every construction contract shall—
> (a) provide an adequate mechanism for determining what payments become due under the contract, and when, and
> (b) provide for a final date for payment in relation to any sum which becomes due. The parties are free to agree how long the period is to be between the date on which a sum becomes
> due and the final date for payment…

18. The purpose of these provisions is clear: to ensure that every construction contract contained a transparent and straightforward mechanism for payment to the contractor by way of stage payments, ending with a final payment, all to be made pursuant to a clear contractual timetable. I would venture to suggest that it was not designed to invalidate a particular type of stage payment or instalment regime; it was simply intended to ensure that there was such a regime in place which met certain minimum standards.

19. This is not a case about s.109. In its Part 8 claim form, Verbus did not seek to challenge Milestones 1-5 on the basis of a failure to comply with s.109. That seems to me to be right: the Milestones clearly amounted to a timetable for stage payments or instalments for work carried out. S.109 was not engaged because the contract contained the necessary timetable.

20. Verbus' challenge relied on s.110(1)(a), on the basis that there was no adequate mechanism for determining what payments became due and when. They accept that there was no difficulty about the amount of each instalment: that was each of Milestones 1-5, expressed as a percentage of the contract sum. Such a methodology is common in ship-building and manufacturing contracts, and, given the nature of the construction work in this case, it is perhaps unsurprising to see a similar formulation agreed here.

4.3 The Relevant Case Law

21. It is common in construction contracts for sums to be payable when a certain stage of the works is reached. Perhaps the best-known example is the usual agreement by an employer to pay 50% of the retention monies when practical completion is achieved.

22. The precise trigger for payment will depend upon the terms of the contract. If, say, an architect's certificate confirming completion of a stage of the work is a condition precedent of payment, then the employer is entitled not to pay if there is no such certificate (see *Wallace v Brandon & Byshottles UDC (1903),* Hudson's Building Contracts, 4th edition, volume 2, paragraph 362). Even then, the contractor may have a cause of action for the sum which ought to have been certified: see *Henry Boot Construction Limited v Alstom Combined Cycles Ltd* [2005] 1 WLR 3850 at 3861.

23. Moreover, if the employer prevents the issue of a certificate, which should otherwise have been issued, he cannot rely on its absence, because "no person can take

advantage of the non-fulfilment of a condition the performance of which has been hindered by himself": see Blackburn J in *Roberts v Bury Commissioners* [1870] LR5CP 310 at 326 and, more recently, *Waddan Hotel Limited v MAN Enterprise SAL (Offshore)* [2015] BLR 478.

24. There are only a handful of cases concerned with s.110 and the Scheme for Construction Contracts. In *Maxi Construction Management Limited v Morton Rolls Limited* [2001] CILL 1784-1787, the contractual payment regime involved an unusual provision which required the agreement of the contractor's valuation by the employer's agent before it was submitted to the employer for payment. Lord Macfadyen held that that was not necessarily incompatible with s.110(1)(a), provided always that there was a timetable for the process of agreement and, just as importantly, a means of resolving any failure to reach such agreement. The problem was that the terms included no such timetable and no such mechanism. In this way, a failure on the part of the employer's agent to agree a valuation could hold up the making of a claim for payment indefinitely. The court therefore concluded that the contract did not comply with the s.110(1)(a) of the Act.

25. In *Alstom Signalling Limited v Jarvis Facilities Limited (No.2)* [2004] EWHC 1285 (TCC), Judge Lloyd QC was dealing with a dispute as to what was meant by a final date. He said that although the payment terms in the contract referred up the contractual chain to the main contract between Alstom and Railtrack, the contract was clear that payment would be made within seven days of a Railtrack certificate. There was therefore certainty as to the final date for payment and the fact that Railtrack, possibly in breach of its own contract with Alstom, might fail to issue that certificate did not mean that, for the purposes of s.110 (1)(b) there was no date for payment to Jarvis.

26. At first instance in the present case, the judge referred to my judgment in *Fenice Investments Inc v Jerram Falkus Construction Limited* [2009] EWHC 3272 (TCC). That was a case where, by reason of a hierarchy clause, the payment provisions that the parties had agreed were adequate, and the Act was not engaged. My comments as to potential non-compatibility were therefore *obiter*. On the assumption that the contractual provision was silent as to the period between an application for payment and the conclusion of the evaluation process, I concluded that – in the context of that case - the mechanism was inadequate.

4.4 Analysis

27. Issue 1 raises primarily a question of interpretation. Does the reference to 'sign-off' in Milestones 2 and 3 stand as a shorthand for the prototype or units being complete, in a condition in which they could be signed-off, or does it mean the date on which they were actually signed-off, thereby allowing Bennett or a third party to refuse to sign off the prototype or the units and deprive Verbus of payment? Is it a generic reference to the satisfactory completion of a particular stage, to be assessed objectively ("the objective interpretation"), or is it a reference to the date on which the sign-off actually occurred ("the subjective interpretation")?

28. I note that the judge's starting point at [21] of the first judgment was that the use of the words "sign-off" in the schedule of Milestones, without reference to any other contract terms, was a shorthand for completion of the appropriate stage (i.e. the

manufacture of the prototype for Milestone 2 and the production of all 78 units for Milestone 3). That, of course, appeared to go some way towards accepting Bennett's case as to the objective interpretation.

29. In addition, contrary to Verbus' challenge, he reached that same conclusion in relation to Milestone 4. At [28] of the first judgment he said:

> "As far as milestone four is concerned, this is different. There is no indication here as to anyone who would actually do the sign-off and, in this context, I consider that the expression is used very loosely. It simply means proof of delivery of the units in Southampton once discharged from the vessel carrying them. I do not consider that it involves checking to see whether they are damaged or not as a condition for a sign-off for payment. That would not affect the position as between the parties, though it might generate claims against the shippers and so on, pursuant to the contract of carriage. Indeed, that is supported by the statement I read at p.138 which made no reference to any inspection once the goods had arrived in Southampton and said that insurance to cover loss of cargo or damage would be provided in any event. Accordingly, in my judgment, milestone four remains intact."

30. Accordingly, it was only those parts of the specification set out in paragraphs 6-8 above, with its various references to "sign-off", which caused the judge to depart from the objective interpretation, and to construe that expression as having a particular meaning for the payment of Milestones 2 and 3.

31. It is not entirely clear what construction of the term 'sign-off" the judge arrived at. But there appear to be three elements of his conclusion in favour of Verbus. First, at [22]-[24] of the first judgment, he said that "the due date for payment was … the date of sign-off". He concluded that, because of the other contract references, Verbus would only be entitled to payment of Milestones 2 and 3 when the prototype and the units themselves were approved as being complete. That involved a requirement that they were *actually* signed off, thereby adopting the subjective interpretation, defined above. This was apparently based on the premise that Bennett or the underlying clients could refuse to sign off the protoype or the units, even if they had reached the necessary stage of completion.

32. Secondly, he suggested at [24] of the first judgment that, because of the involvement of the 'client's representative', the criterion to be applied to any sign off was itself uncertain and vague ("the criterion issue").

33. Thirdly, the judge appears to suggest at [26]-[27] that the mechanism was inadequate because no date for the payment of the relevant percentages was expressed in the contract ("the date point").

34. For the reasons set out below, I differ from the judge on each of those three issues.

The Subjective Interpretation

35. Taking first the point as to whether sign-off was to be assessed subjectively or objectively, I consider that as a matter of construction, it was objective. The judge had

no difficulty in reaching that conclusion in respect of Milestone 4, and offering that tentative conclusion for the other Milestones too (paragraph 28 above). The only basis for his contrary conclusion was the particular references in the specification. But I do not consider that those references make any difference to the proper construction of the term. It is plain, taking the contract as a whole, that the parties intended that, on completion of the relevant stage, the Milestone would be paid.

36. There was nothing in the contract which sought to tie in sign-off to the production of a certificate or record of any sort. There was no condition precedent by which, for example, a certificate signed by Bennett (or Key Homes or Park Inn) was required before payment of 20% of the contract sum on completion of the prototype: see the discussion in paragraph 22 above. Ms Doerries said that this aided her construction of the contract, and I agree. If actual sign-off was required, the contract would have said so. Moreover, 'sign-off' is used in different ways and in different contexts in the contract documents, often to denote rather loosely approval of some sort, which militates against any interpretation which imports undue formality into the phrase.

37. But assuming that I am wrong and that these contractual provisions did envisage the actual completion or certification of a signed off document, it makes no difference to my conclusion as to the adequacy of the payment mechanism. Let us imagine that, contrary to my view, the contract required the prototype actually to be signed off by Bennett (or Key Homes or Park Inn) before Milestone 2 was paid. That would make no difference to Verbus' entitlement to be paid once completion of the prototype had been achieved. If it was in a state where it could be signed off, Bennett could not avoid their liability to pay Milestone 2 simply because the document had not in fact been signed off: see the discussion in paragraph 23 above.

38. This is therefore a case with some similarities to *Alstom v Jarvis*, where the potential involvement of others in the process did not invalidate the payment regime. It is not like *Maxi Construction*, which was an unusual regime where a third party was involved and had to agree before a claim could even be made.

39. Accordingly, I can see no difficulty at all with the use of the word "sign-off" in Milestones 2 and 3. It denoted the objective state which the prototype and then the units had to reach before the payment was due. It did not require an actual signing-off. But even if it did, that could not affect Verbus' entitlement to be paid because, if the prototype or the units were in the state in which they were capable of being signed off, Verbus were entitled to be paid, and a failure to sign-off the relevant documentation would not be a defence to a claim based on that entitlement.

The Criterion Issue

40. Secondly, I consider that the potential involvement of third parties (Key Homes and Park Inn) in any sign-off process did not detract from the only applicable criterion, namely completion of the prototype or the units in accordance with the contract. The points made above, to the effect that wrongful interference cannot prevent proper payment, are repeated.

41. On a proper interpretation of the contract, the only relevant criterion was compliance with the contract specification: if that was (objectively) achieved, the works were

capable of being signed off and Milestone 2 (for the prototype) and Milestone 3 (for the units themselves) became payable, whether they were actually signed off, or not.

The Date Point

42. For completeness, I should address the issue of timing. Part of Mr Sears' complaint was that there was no mechanism by which, once sign-off had been reached, a payment would be made: there was no date for an invoice, no date that the sum fell due; no final date for payment. I accept that such dates were not spelt out. But I do 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. Contrary to the suggestion at [16] at the first judgment, *Fenice Investments* is of no direct relevance on this issue. That was a contract with monthly payments and the problem was a clash between two different sets of conditions.

43. The proposition that no specified date was required to make this regime work is borne out by Judge Waksman's conclusions in respect of Milestone 4, which did not contain a specific date for payment. It merely identified the event (sign-off on delivery in Southampton) which would trigger that payment. There was no difficulty about the certainty of that payment arrangement, and Judge Waksman rightly upheld it.

44. The relevant completion date (of prototype and units) was therefore the date on which the payment of Milestones 2 and 3 became payable. The fact that there was no express date for payment does not matter, because the sum was payable when that completion was achieved.

4.5 Summary on Issue 1

45. For these reasons, I consider that the judge was wrong to find that this contract did not contain an adequate mechanism for determining what payments became due under the contract, and when. In my view, the contract contained an adequate mechanism in accordance with s.110. Accordingly, I consider that the first ground of this appeal should be allowed. However, because of its wider importance, it is appropriate to go on and consider the arguments in respect of the second ground. I do that on the basis that, contrary to the views set out above, the contractual mechanism did not contain an adequate payment mechanism.

5 ISSUE 2: IF MILESTONES 2 AND 3 DID NOT COMPLY WITH THE ACT, WHAT WAS THE CORRECT MECHANISM OF REPLACEMENT?

5.1 Overview

46. Verbus had originally argued (and the judge agreed) that, not only did paragraphs 2-4 of Part II of The Scheme for Construction Contracts (England and Wales) Regulations 1998 ("Part II of the Scheme") have to be implied, but that, because of the difficulties of mixing and matching the interim valuation process in paragraph 2 (on the one hand) and the original percentages of the contract sum (on the other), paragraphs 2-4 should replace the Milestone mechanism in full, and the entire payment arrangement should be based on interim valuations. One further consequence of this approach was

that the arrangements in respect of Milestones 4 and 5 also had to be rewritten, even though there was nothing wrong with those specific provisions themselves.

47. As Mr Sears submitted at the appeal hearing, this approach was based on the premise that paragraph 2 of Part II of the Scheme was the only applicable paragraph because it related to interim and stage payments. He argued that the alternative option, paragraph 7, dealing with "other payments", was merely a kind of catch-all which did not relate to interim or stage payments. He submitted that, in consequence, the analysis never needed to engage with paragraph 7 at all.

48. Ms Doerries disputed that approach. She said that the judge had been wrong to treat Milestones 2 and 3 as interim or stage payments "of a kind mentioned" in paragraph 2. That was, in particular, because there was no agreement here as to interim valuations, which was the focus of paragraph 2. Accordingly, she said that the most apposite provision was paragraph 7, which would mean that an entitlement to payment arose seven days after the completion of the work to which the payment related. Importantly, she said that this avoided any payment arrangement by reference to value. In addition, she said that this fitted in not only with the agreed concept behind Milestones 2 and 3, but also with the Milestones whose validity was either not in issue (Milestones 1 and 5) or had been upheld by the judge (Milestone 4).

5.2 The Statutory Framework

49. As noted above, pursuant to s.110(3), "if or to the extent that a contract does not contain" adequate mechanisms for payment, "the relevant provisions of the Scheme for Construction Contracts apply". Section 114 provides that the provisions operate by way of implied terms. Accordingly, on the assumption that the answer to Issue 1 was that the contract did not contain an adequate mechanism, it is necessary to turn to the Scheme to find the necessary replacement terms. They are in Part II. The relevant paragraphs are as follows:

> 1. Where the parties to a relevant construction contract fail to agree—
> (a)the amount of any instalment or stage or periodic payment for any work under the contract, or
> (b)the intervals at which, or circumstances in which, such payments become due under that contract, or
> (c)both of the matters mentioned in sub-paragraphs (a) and (b) above,
> the relevant provisions of paragraphs 2 to 4 below shall apply.
> 2.—(1) The amount of any payment by way of instalments or stage or periodic payments in respect of a relevant period shall be the difference between the amount determined in accordance with sub-paragraph (2) and the amount determined in accordance with sub-paragraph (3).
> (2) The aggregate of the following amounts—
> (a)an amount equal to the value of any work performed in accordance with the relevant construction contract during the period from the commencement of the contract to the end of the relevant period (excluding any amount calculated in accordance with sub-paragraph (b)),

(b)where the contract provides for payment for materials, an amount equal to the value of any materials manufactured on site or brought onto site for the purposes of the works during the period from the commencement of the contract to the end of the relevant period, and
(c) any other amount or sum which the contract specifies shall be payable during or in respect of the period from the commencement of the contract to the end of the relevant period.
(3) The aggregate of any sums which have been paid or are due for payment by way of instalments, stage or periodic payments during the period from the commencement of the contract to the end of the relevant period.
(4) An amount calculated in accordance with this paragraph shall not exceed the difference between—
(a) the contract price, and
(b) the aggregate of the instalments or stage or periodic payments which have become due.
3. Where the parties to a construction contract fail to provide an adequate mechanism for determining either what payments become due under the contract, or when they become due for payment, or both, the relevant provisions of paragraphs 4 to 7 shall apply.
4. Any payment of a kind mentioned in paragraph 2 above shall become due on whichever of the following dates occurs later—
(a)the expiry of 7 days following the relevant period mentioned in paragraph 2(1) above, or
(b)the making of a claim by the payee.
5. The final payment payable under a relevant construction contract, namely the payment of an amount equal to the difference (if any) between—
(a) the contract price, and
(b) the aggregate of any instalment or stage or periodic payments which have become due under the contract,
shall become due on the expiry of—
(a) 30 days following completion of the work, or
(b) the making of a claim by the payee,
whichever is the later.
6. Payment of the contract price under a construction contract (not being a relevant construction contract) shall become due on
(a) the expiry of 30 days following the completion of the work, or
(b) the making of a claim by the payee,
whichever is the later.
7. Any other payment under a construction contract shall become due
(a) on the expiry of 7 days following the completion of the work to which the payment relates, or
(b) the making of a claim by the payee, whichever is the later.

5.3 The Relevant Case Law

(a) Wholesale or Partial Incorporation?

50. The Scheme is divided into two parts: Part I (which is otherwise immaterial for the purposes of this appeal) deals with the adjudication provisions to be incorporated if the contract did not contain a proper adjudication clause. Part II sets out the more complex provisions which apply if the parties failed to agree compliant payment conditions. Although there has been a certain amount of confusion in the authorities as to whether, in cases of non-compliance, these Parts are to be incorporated wholesale or only where necessary, I consider that the position is now clear.

51. Part I of the Scheme, dealing with adjudication provisions, is a series of "all or nothing" provisions. If the contract does not contain proper adjudication provisions, then Part I of the scheme applies "lock, stock and barrel": see Edwards-Stuart J in *Yuanda (UK) Co Limited v WW Gear Construction Limited* [2010] BLR 435 at [61]. That is because of s.108 of the Act and the straightforward provision in s.108(5) that, if the contract did not comply with the Act, "the adjudication provisions of the Scheme for Construction Contracts apply". There is nothing to say that such incorporation would only be to the extent necessary.

52. But Part II of the Scheme is different. The payment provisions there are incorporated where the contractual provisions are non-compliant, but s.110(3) makes plain that that is only "if or to the extent that" the contract does not contain the relevant provisions. As I pointed out in *Banner Holdings Limited v Colchester Borough Council* [2010] EWHC 139 (TCC); [2010] 131 Con LR 77, the words "to the extent that" are missing from s.108. That indicates that piecemeal incorporation is permitted in respect of the payment provisions in Part II of the Scheme in a way that is not permitted in respect of Part I.

53. That was always the approach in Scotland: see *Hills Electrical & Mechanical plc v Dawn Construction Limited* [2004] SLT 477. In that case Lord Clarke found that some of the payment provisions did not comply with the Act and that therefore Part II of the Scheme had to apply, but only to the extent that the express terms of the contract omitted particular requirements of the Act. That approach has been followed in England in a number of more recent cases. I note in particular that in *Grove Developments v Balfour Beatty Regional Construction Ltd* [2016] EWHC 168 (TCC); 165 Con LR 153, Stuart-Smith J said:

> In *Yuanda (UK) Co Ltd v WW Gear Construction* [2010] BLR 435 at [55]ff Edwards-Stuart J contrasted the words of s. 108 of the Act (which incorporates the Adjudication provisions of the Scheme) with those of ss. 109, 110 and 113 (which incorporate the Payment provisions of the Scheme). He concluded at [62] that, where s. 108 of the Act applies to bring the Scheme's provisions concerning adjudication into play, it implements all of those provisions of the Scheme. At [63]-[64] he contrasted the position pursuant to s. 108 relating to Adjudication provisions with the position pursuant to ss. 109 and 110 relating to the Payment provisions of the scheme and expressed his agreement with the reasoning of the Outer House in the Scottish Case of *Hills Electrical & Mechanical v Dawn Construction Ltd* [2004] SLT 477. In *Hills*, Lord Clarke decided on the basis of the wording used in ss 109 and 110 that the approach of the legislature when dealing with the Payment provisions of the Scheme was not

> automatically to incorporate all of the Payment provisions but was to import the appropriate provision or provisions of the Scheme in order to make up for their omission or inadequacy in the Construction contract.
>
> I also respectfully agree with the reasoning and decision in *Hills Electrical*. It follows that where s. 109 or s. 110 is engaged, the provisions of the Scheme as to Payment will only be imported and apply so as to govern the legal relations of the parties to the extent that they have not already concluded binding contractual arrangements that can remain operative. They will not automatically or necessarily be imported in their entirety. It is of course possible that the existing arrangements under a given contract are not capable of forming part of a payment scheme when read with the relevant provisions of the Scheme. If that were the case it may be necessary to import the Scheme's Payment provisions as a whole. But that is not a necessary or correct outcome if the existing contractual arrangements are capable of co-existing with some of the Payment provisions of the Scheme to form a coherent whole.

The decision was upheld by the Court of Appeal ([2016] EWCA Civ 990; [2017] 1 WLR 1893).

54. Accordingly, I regard it as settled law that, where payment provisions do not comply with s.109 or s.110 of the Act, Part II of the Scheme applies, but only to the extent that such implication is necessary to achieve what is required by the Act.

(b) *The correct approach to Part II*

55. There is very little authority as to how the court should go about the task required by Part II. In *Alstom v Jarvis,* Judge Lloyd made a number of references to the tortuous nature of the drafting, and the "maze-like" exercise required to arrive at the answer. In *Banner* I complained that it should not really be the court's job to have to piece together one set of compliant provisions from two different sources. Judge Waksman made a similar complaint in the current case.

56. The few authorities dealing with the approach to be applied to payment provisions which do not contain an adequate mechanism required by s.110 are concerned with the particular provisions relating to final payments. So, other than those cases previously noted, leading counsel were unable to find any authority dealing with the interplay between an inadequate mechanism for periodic or interim payments, and paragraphs 1-7 of Part II of the Scheme.

5.4 Analysis

57. For the reasons explained below, I have concluded that Ms Doerries' approach to Part II of the Scheme is to be preferred. Although Part II of the Scheme is badly drafted, I think it is possible to pilot a course through it in order to achieve a common sense result that, when applied to this case, does no significant violence to the parties' original agreement.

58. First, I think she is right to note that paragraphs 1 and 2 of Part II of the Scheme are intended to deal with the problem identified by s.109 of the Act, namely contracts that do not contain provisions for the payment of instalments or stage or periodic payments. The wording of paragraph 1 is precisely the same as s.109. By the same token, paragraph 3, which is under a separate sub-heading within Part II, reflects precisely the words of s.110.

59. As previously noted, this case is not concerned with s.109. Accordingly, save for the reference in paragraph 4, paragraph 2 of Part II of the Scheme is irrelevant to this appeal. Instead, this is a case concerned with s.110. On the assumption that the parties failed to provide an adequate mechanism for determining either what payments become due under the contract or when they become due for payment, the replacement mechanism is said to be expressly addressed by paragraph 3 and following.

60. How do those paragraphs work? It seems to me that they identify four different kinds of payment. Paragraph 4 identifies "payments of a kind mentioned in paragraph 2". Paragraph 5 is concerned with final payments. Paragraph 6 is concerned with excepted contracts, and paragraph 7 with "other payments".

61. Working through those options, this is not a final payment or a payment under an excepted contract, so neither paragraph 5 nor paragraph 6 can be relevant. Equally, it seems to me that paragraph 4 cannot be relevant either. That is because the Milestones in this case are not the "kind of payment mentioned in paragraph 2". I accept that, superficially, Milestones 2 and 3 could be said to be instalments or stage payments, and that therefore paragraph 2 might apply. But I do not consider that, on analysis, it is correct to say that Milestones 2 and 3 are "payments of a kind mentioned" in paragraph 2.

62. Why not? Because "payments of a kind mentioned" appears to be a clear reference to the particular type or kind of payment with which paragraph 2 is expressly concerned. That is a payment based on "the value of any work performed": see paragraph 2(2)(a) and following. But Milestones 2 and 3 were not payments based on the value of any work performed. They were based solely on completion of a particular stage of the works. They were not therefore payments "of a kind" referred to in paragraph 2.

63. By a process of elimination, therefore, paragraph 7, which I consider was indeed intended to be a 'catch all', is the only paragraph that could relate to these Milestones. Moreover, that proposition makes commercial sense. It means that, on the assumption that the agreed mechanism is inadequate because there was no agreement as to timetable for payment, such a timetable is provided by paragraph 7 (7 days after completion). And it resolves any concern about the sign-off provision (and the possible requirement for actual sign-off or doubts about the criteria) because it provides for payment after the completion of the relevant work (i.e. an objective test as to completion).

64. But if (contrary to my primary view) Mr Sears was right and the analysis must start with paragraphs 1 and 2, I consider that precisely the same conclusion would result. If the problems here were the criteria which triggered a payment, and the timing of that payment, they would be covered in paragraph 1 by the phrase "circumstances in which such payments become due". What are the provisions to be implied where

there is an inadequate mechanism dealing with the circumstances in which payments are due? The answer is said to be provided by paragraph 3, which in turn takes the reader to paragraphs 4-7, and therefore the analysis already set out above.

65. Accordingly, it seems to me that, in a case where the parties did not agree a payment arrangement by reference to interim valuations of the work done, Part II of the Scheme did not impose such a regime. On the assumption that the mechanism in respect of both date and criteria for payment was inadequate in some way, both can be resolved in straightforward fashion by the implication of paragraph 7. In that way, the payment in respect of Milestone 2 would be 7 days following the completion of the prototype in accordance with the contract. For Milestone 3, it would be 7 days following the completion of the units in accordance with the contract. Milestones 1, 4 and 5 would remain wholly unaffected.

66. It follows from the above that the right replacement option (paragraph 7 of Part II of the Scheme) does the least violence to the agreement between the parties. The adoption of the least damaging option also happened in *Alstom v Jarvis*. Furthermore, the importance of the parties' original agreement, notwithstanding the provisions of the Act, was stressed by the Court of Appeal in *Grove Developments v Balfour Beatty*. It seems to me that, when dealing with Part II of the Scheme, these are matters which should be central to the court's considerations.

67. That links to a wider point about the underlying purpose of the Act. As previously noted, in relation to payment provisions, the purpose of the Act was to provide for certain minimum, mandatory standards so as to achieve certainty and regular cash flow. Save in perhaps exceptional circumstances, it was not designed to delete a workable payment regime which the parties had agreed, and replace it with an entirely different payment regime based on a radically changed set of parameters. It seems to me that that could only happen where the regime which had been agreed was so deficient that wholesale replacement was the only viable option. That is plainly not this case.

6 CONCLUSION

68. Accordingly, for the reasons which I have given, if my Lords agree, this appeal will be allowed. Verbus' claims for the declarations in the claim form will be dismissed.

Mr Justice Snowden

69. I agree.

Lord Justice Longmore

70. I also agree.

Judgment Approved by the court for handing down.