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BRIEFING

BALFOUR BEATTY REGIONAL CONSTRUCTION LIMITED V GROVE DEVELOPMENTS LIMITED

OCTOBER 2016

- COURT OF APPEAL CONSIDERS WHETHER CONTRACTOR ENTITLED TO INTERIM PAYMENTS FOR ANY WORK UNDER CONSTRUCTION CONTRACT

INTRODUCTION

This case is yet another in a spate of cases which relate to the operation of the statutory payment regime introduced by the Housing Grants, Construction and Regeneration Act 1996 and as subsequently amended by Part 8 of the Local Democracy, Economic Development and Construction Act 2009 (together "the Act"). A key objective of the Act was the reform of payment practices within the construction industry by requiring that all construction contracts, which fall within the Act and are more than 45 days in duration, provide for a system of periodic payments for the duration of the works.

"THE REGIME HAS PROVED SOMEWHAT OF A MINEFIELD FOR CONTRACTORS AND EMPLOYERS ALIKE."

In practice, the regime has proved somewhat of a minefield for Contractors and Employers alike. As discussed in our Briefing Note of October 2015, the Act prescribes that each payment cycle is initiated by a specific event or date and thereafter there are further specific dates by which the Employer must issue its Payment Notice (which effectively sets out the value of the works undertaken to date) and thereafter for the issue of a 'Payless Notice' if the Employer intends to pay the Contractor less than the sum set out in the Payment Notice. Failure to strictly observe these dates to the letter can have very serious implications for both Employers and Contractors.

By way of background the relevant cases are summarised below:

ISG Construction Ltd v Seevic College [2014] EWHC 4007 (TCC) and *Galliford Try Building Ltd v Estura Ltd* [2015] EWHC 412 (TCC)

An Employer's failure to serve a Payment Notice by the specified date can result, subject to the issue of a valid Payless Notice, in the Employer having to pay whatever sum is stated as due in the Contractor's application (provided that application complies with section 110B(4) of the Act). It also means that the Employer is deemed to have agreed to the value of the works claimed in the application and that the Employer could not, therefore, adjudicate over the proper value of the interim payment.

In *Galliford Try* the TCC granted a partial stay of execution, on the grounds that it would cause "manifest injustice" to the Employer if the Adjudicator's decision was to be enforced in full. However, such a "lifeline" is only likely to be available to Employers in extreme cases and if 'exceptional' facts warrant it.

An illustration of what constitutes "manifest injustice" can be seen in the Court's approach in the case of *Harding (t/a MJ Harding Contractors) v Paice and Another* [2014] EWHC 3824 (TCC). Here the Court found that the absence of a Payless Notice cannot convert a sum that is not properly due (based on the actual valuation of the works) into one that is properly due *forever*. This case involved a dispute in relation to what was due in respect of a Final Account. An Adjudicator's award in those circumstances, that the full amount applied for was due, would mean that a dispute over payment would have been resolved for all time due to the failure to serve a Payless Notice in time and in the correct form. Such a result would be more draconian than the contractual regime that applied to the final certificate since the parties had the ability to challenge that within 28 days. The Court's findings were clearly influenced by the fact that this case concerned a Final Account and consequences of a failure to issue a Payless Notice could not be corrected in the next payment cycle.

Conversely, in *Leeds City Council v Waco UK Ltd* [2015] EWHC 1400 (TCC) the Court found that a Contractor's failure to serve an application on the right date can mean it loses its right to that payment in that month.

In accordance with the decisions in the cases above, except in rare circumstances, the Employer must pay whatever the Contractor has applied for first and argue about it later or correct the situation in the next payment cycle, for example, by issuing a Payment Notice on the correct date setting out the sum the Employer considers is due to the Contractor and/or by then issuing a Payless Notice by the appropriate date. The latter option may be difficult in practice depending on the point at which the works have reached, the difference between the payment the Contractor applied for and the works as valued by the Employer; the extent of any liability for Liquidated Damages; and the number of payment cycles remaining before completion. In reality the extent of the sum applied for may be such that there is little opportunity to 'claw' it back in the next payment cycle.

Given the ramifications of 'missing' the various key dates it has become increasingly common for parties to agree a payment schedule setting these out and thereafter to incorporate this into the contract. Frequently, these schedules only set out the relevant dates up until the contractual completion date.

Balfour Beatty Regional Construction Limited v Grove Developments Limited [2016] EWCA Civ 990

"WHAT HAPPENS IF THE WORKS ARE DELAYED AND NEITHER THE SCHEDULE NOR THE CONTRACT PROVIDES FOR AN AGREED REGIME FOR WHEN PAYMENTS ARE TO BE MADE ONCE THE CONTRACTUAL COMPLETION DATE HAS PASSED BUT THE WORKS ARE CONTINUING?"

The issue for determination

In this case the issue for the Court at first instance and the Court of Appeal to decide was what happens if the works are delayed and neither the schedule nor the contract provides for an agreed regime for when payments are to be made once the contractual completion date has passed but the works are continuing?

The facts

Grove engaged Balfour Beatty to design and construct a hotel and serviced apartments in south east London pursuant to an amended JCT standard form Design and Build Contract 2011 ("JCT DAB 2011"). The contractual completion date was 22 July 2015. The contract required the parties to choose the basis on which interim payments were to be made:

A) Under Alternative A, an application for an interim payment was to be made as at completion of each stage specified in the contract particulars. Following the application in respect of the last stage, such applications were to be made at two monthly intervals up to the expiry of the Rectification Period or the issue of the Notice of Completion of Making Good; or

B) Under Alternative B the applications were to be made as at the monthly dates specified in the contract particulars up to the date of practical completion. Subsequent applications were again to be made at two monthly intervals, up to the expiry of the Rectification Period or the issue of the Notice of Completion of Making Good.

In this case the parties selected Alternative A and crossed out Alternative B. However, they were unable to agree a list of stages and so ultimately agreed that Grove would make interim payments to Balfour Beatty in accordance with a schedule which set out a series of dates on which the application should be submitted (being the third Thursday of each month), up to 16 July 2015. The schedule provided for 23 interim payments up to the contractually agreed date for practical completion.

Interim payments were made in accordance with the timetable in the schedule up to July 2015. However, in the meantime and by May 2015 it was apparent that the project was going to overrun substantially and the parties were unable to agree how the mechanism for interim payments would operate after July 2015. Notwithstanding this, Balfour Beatty continued to issue interim applications and in August 2015 issued Interim Application 24 ("IA 24"), claiming £23,166,425.92. Consequently the Employer, Grove issued proceedings in the TCC seeking a declaration that Balfour Beatty had no entitlement to interim payments after July 2015. At first instance the judge agreed with Grove's argument and Balfour Beatty appealed.

The Appeal

There were three grounds of appeal:

Ground 1: That the schedule expressly or impliedly provided for continuing payments to be made between August 2015 and the date of practical completion.

"THIS WAS A CLASSIC CASE OF ONE PARTY MAKING A BAD BARGAIN, AND THE COURT WOULD NOT AND COULD NOT USE THE CANONS OF CONSTRUCTION TO RESCUE THAT PARTY FROM THE CONSEQUENCES OF WHAT IT HAD AGREED."

Lord Justice Jackson and Lord Justice Longmore rejected this argument. Lord Justice Jackson noted that it was common ground that by agreeing to the schedule the parties had abandoned Alternative A. However, in his view that did not mean the parties had simply agreed to adopt Alternative B (and accordingly these provisions in applications for interim payments in circumstances where the contractual date for completion had passed). Instead, what they agreed was a hybrid arrangement which had elements of Alternative B and a timetable of their own invention which ended on 22 July 2015. Thereafter there was no agreement as to whether or how they would deal with interim payments. The Judge noted that it was impossible to deduce from the hybrid arrangement the dates for valuations, Payment Notices, Payless Notices and payments after July 2015. While Balfour Beatty argued that the parties could not have intended that, if practical completion was delayed, it would have to wait for payment until the final payment date i.e. that the Schedule provided for continuing payments to be made between August 2015 and the date for practical completion, Lord Justice Jackson commented that this was a classic case of one party making a bad bargain, and the court would not and could not use the canons of construction to rescue that party from the consequences of what it had agreed.

Lord Justice Jackson also concluded that the case fell far short of satisfying the requirements for implication of the proposed term, since it was not obvious what that term would say or what would be the critical dates for serving notices, and the proposed term was not necessary to secure business efficacy. Lord Justice Vos expressed a contrary view and considered that the parties had opted to revert to the applicability of Alternative B. However, he was in the minority.

Ground 2: Alternatively, the Contract as amended by the schedule did not comply with the requirements of section 109 of the Act, and accordingly the Scheme for Construction Contracts as set out in the Scheme for Construction Contracts (England and Wales) Regulations 1998 (the "Scheme") applied, conferring a statutory right to monthly interim payments between August 2015 and practical completion.

As to this argument, Lord Justice Jackson noted that section 109(1) of the Act provides that:

A party to a construction contract is entitled to payments by instalments, stage payments or other periodic payments for any work under the contract [except in relation to projects specified or estimated to be less than 45 days].

"THE REFERENCE TO 'ANY WORK' IN SECTION 109(1) DID NOT MEAN 'EVERY SINGLE PIECE OF WORK'."

Balfour Beatty contended that "any" meant "all", relying on the decision in *Clarke-Jervoise v Scutt* [1920] 1 Ch 382. However, Lord Justice Jackson did not consider that the judge in that case meant that in every context "any" means "all", and in his view the reference to "any work" in section 109(1) did not mean "every single piece of work". Instead, the subsection was more general, and said that work done under construction contracts shall (except in very short projects) be subject to a regime of interim payments. He noted that section 109(2) then goes on to give the parties considerable latitude as to the system of interim payments which they may agree. There was a question as to whether contracting parties could frustrate Parliament's intention by agreeing a pitifully inadequate scheme of interim payments but the judge doubted that a cynical device to exclude operation of the Scheme by prescribing one interim payment "of an insignificant amount" would suffice, but it was ultimately not necessary to determine that issue as, in his view, the contract in this case, as amended by the schedule, did satisfy the requirements for section 109.

Accordingly, the Scheme did not apply and Balfour Beatty could not rely on it to recover interim payments after July 2015.

Ground 3: Alternatively, the parties' correspondence and conduct in the summer and autumn of 2015 gave rise to a fresh contract for monthly interim payments.

As to the final ground of appeal, Lord Justice Jackson noted that, although the parties had continued to correspond and serve notices on the assumption that interim payments were due between August and November 2015, they never reached agreement about the applicable dates which they both treated as essential elements of any contract. Accordingly it was impossible to derive any fresh agreement between the parties from their conduct or correspondence.

The appeal was accordingly dismissed.

Conclusion

In accordance with this decision, where parties include a payment schedule in their contract that does not make express provision for further interim payments should the works be delayed, the Contractor is only entitled to apply for those payments set out in the schedule and has no right to make any further applications for interim payments, even though works are ongoing, and must wait until the final payment mechanism is triggered upon the certification of practical completion. In this case, Balfour Beatty and Grove had only agreed for 23 interim payments and the TCC and the Court of Appeal have decided that was all Balfour Beatty was entitled to until the contractual completion date was met. Balfour Beatty had no right to make any further applications for payment until after that point.

"THE EFFECT OF THIS DECISION IS THAT A CONTRACTOR COULD FACE A SITUATION WHERE THE WORKS ARE SUBSTANTIALLY DELAYED AND IT IS EFFECTIVELY STARVED OF CASH UNTIL THE ACHIEVEMENT OF PRACTICAL COMPLETION OR THE RELEVANT CONTRACTUAL COMPLETION DATE WHICH IS APPLICABLE."

Commentary

This decision will strike many as unduly harsh and indeed it is seemingly at odds with what is arguably the principal rationale for the introduction of the Act and the requirement for regimes for interim payments in the first place: to ensure cash flow is unimpeded and to guard against the crisis the UK construction industry faced prior to the issue of the Latham report in 1994, that is where cash flow was stymied by, among other things, protracted payment disputes.

The effect of this decision is that a Contractor could face a situation where the works are substantially delayed and it is effectively starved of cash until the achievement of practical completion or the relevant contractual completion date which is applicable. This could place intolerable pressure on a Contractor already struggling financially due to late completion or for other reasons. Cutting off the Contractor's cash lifeline at this point will quite likely exacerbate existing delay and worse, may place both the Contractor and the works in jeopardy. One would have thought that this is in neither party's interests and that this is precisely the situation the Act sought to address and avoid.

Notwithstanding that the schedule did not set out what was to happen in circumstances where all 23 payments had been made but practical completion had not been achieved, many within the industry are likely to consider this result unnecessarily draconian and perhaps even instinctively wrong. Arguably a fairer and more common sense approach would have been to find that there was an implied term that the payment regime would continue in accordance with the convention set out in the schedule i.e. that the dates for applications would continue on the specified

date, the third Thursday of each month until the date of practical completion. This would more or less reflect the situation that is provided for in Alternative B in the JCT DAB 2011. There would still have been certainty as to the dates by which applications and notices were due and the Employer would still be in a position to protect its interests in the usual way by issuing Payment and/or Payless Notices (as applicable) by the requisite dates.

As a consequence of this decision parties, and Contractors in particular, should be wary of adopting 'hybrid' payment regimes which depart from the usual contract position. If the parties decide to do so, they should be particularly careful to ensure that the regime agreed upon does not leave them 'short' or in a period of uncertainty if the works are delayed beyond the contractual completion date. If a schedule is agreed parties should ensure that they expressly make provision for what happens if the schedule 'runs out' before the contractual completion date is achieved. Arguably best practice is to agree to a regime akin to Alternative B which allows for clarity but also affords flexibility in circumstances where, for whatever reason, the contractually agreed completion date is not met, but ensure that a schedule is maintained internally setting out all key dates and that there is a contingency system in place to make sure these are not missed. Both parties should strive to reach clear and certain agreement at the outset in order to avoid potentially lengthy and costly disputes later on.

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with a member of our team below or your regular contact at Watson Farley & Williams.

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