

EXTRA DIVISION, INNER HOUSE, COURT OF SESSION

Lord Nimmo Smith

[2005CSIH88]

Lord Mackay of Drumadoon

A752/04

Lord MacLean

OPINION OF THE COURT

delivered by LORD NIMMO SMITH

in the cause

MELVILLE DUNDAS LIMITED (in receivership)
AND THE JOINT RECEIVERS THEREOF

Pursuers and Reclaimers;

against

GEORGE WIMPEY UK LIMITED

Defenders and Respondents;

and

NORWICH UNION INSURANCE LIMITED

Third Parties;

Act: Howie, Q.C.; Maclay Murray & Spens (Pursuers and Reclaimers)

Alt: Currie, Q.C., Henderson; Lindsays, W.S. (Defenders and Respondents)

Alt: McNeill, Q.C.; MacRoberts (Third Parties)

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15 December 2005

The reclaiming motion

[1] This is a reclaiming motion by the pursuers against a decision of Lord Clarke dated 22 October 2004. The pursuers conclude for payment to them by the defenders of a sum of money and interest. They aver that they are entitled to receive payment from the defenders of this sum in terms of a contract between them. The Lord Ordinary, however, having considered the relevant provisions of the contract and of the Housing Grants, Construction and Regeneration Act 1996 ("the 1996 Act"), in the circumstances which had occurred, held that the pursuers are not entitled to claim payment of this sum and accordingly dismissed the

action as being irrelevant. The question for us to consider is whether the Lord Ordinary's interpretation of the statutory and contractual provisions was correct.

[2] On 7 and 26 March 2002 the first-named pursuers (who are now in receivership, but whom for convenience we call "the pursuers", although the receivers are also pursuers) entered into a contract with the defenders for the design, construction and completion of a residential development at Ayr Road, Whitecraigs, Glasgow ("the contract"). The form of contract was the Scottish Building Contract with Contractor's Design Sectional Completion Edition (January 2000 Revision), issued by the Scottish Building Contract Committee ("SBCC"). In terms thereof the rights and duties of the pursuers as the employer and the defenders as the contractor thereunder were regulated by *inter alia* the Conditions of the Standard Form of Building Contract with Contractor's Design 1998 Edition, issued by the Joint Contracts Tribunal Limited ("JCT 1998"), amendments thereto made by the JCT Amendment 1 dated June 1999 and JCT Amendment 2 dated January 2000, and the amendments and modifications contained in the Scottish Supplement for Sectional Completion issued by the SBCC.

[3] In furtherance of the project the defenders entered into a contract performance guarantee bond with the third parties. The third parties were convened to the proceedings by the defenders on the basis that, *estō* the defenders are liable to the pursuers for the sum in question, they are entitled to recover payment of it from the third parties. The third parties contest the liability of the defenders to pay the pursuers this sum. It is a matter of agreement among all the parties that the third parties have an interest in the subject-matter of this action, and it is accepted accordingly that they had been properly convened.

The 1996 Act

[4] Part II of the 1996 Act contains provisions, set out in sections 104 to 117, relating to construction contracts. The expression "construction contract" is defined in section 104, in terms which need not be repeated here because it is not in dispute that the contract was a construction contract as so defined.

[5] Section 109 provides *inter alia*:

"(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.

(4) References in the following sections to a payment under the contract include a payment by virtue of this section."

[6] Section 110 provides:

"(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.

(2) Every construction contract shall provide for the giving of notice by a party not later than five days after the date on which a payment becomes due from him under the contract, or would have become due if -

(a) the other party had carried out his obligations under the contract, and

(b) no set-off or abatement was permitted by reference to any sum claimed to be due under one or more other contracts,

specifying the amount (if any) of the payment made or proposed to be made, and the basis on which that amount was calculated.

(3) If or to the extent that a contract does not contain such provision as is mentioned in subsection (1) and (2), the relevant provisions of the Scheme for Construction Contracts apply."

[7] Section 111 provides *inter alia*:

"(1) A party to a construction contract may not withhold payment after the final date for payment of a sum due under the contract unless he has given an effective notice of intention to withhold payment.

The notice mentioned in section 110(2) may suffice as a notice of intention to withhold payment if it complies with the requirements of this section.

(2) To be effective such a notice must specify -

(a) the amount proposed to be withheld and the ground for withholding payment, or

(b) if there is more than one ground, each ground and the amount attributable to it,

and must be given not later than the prescribed period before the final date for payment.

(3) The parties are free to agree what that prescribed period is to be.

In the absence of such agreement, the period shall be that provided by the Scheme for Construction Contracts."

[8] For Scotland, the Scheme for Construction Contracts is contained in the Scheme for Construction Contracts (Scotland) Regulations 1998 (S.I. 1998/687) ("the scheme"). It was not suggested to us that any provision of the scheme was of relevance for present purposes.

JCT 1998

[9] JCT 1998 was a revision which took account of the provisions of the 1996 Act. Clause 30, so far as material for present purposes, provides *inter alia*:

"30 Payments

30.1 .1 .1
Interim Payments shall be made by the Employer to the Contractor in accordance with clauses 30.1 to 30.4 and whichever of the Alternatives A or B in Appendix 2 applies to this Contract."

By Appendix III to the contract (as distinct from the conditions) the parties made provision in respect of alternative methods of payment. The Appendix provides:

"Clause 30.1: Interim Payments shall be made in accordance with Clause 30 and:

periodically in accordance with Alternative B and Clause 30.2A shall not apply."

[10] Clause 30.3, so far as material, provides as follows:

"30.3 .1 The Contractor shall make Applications for Interim Payment as follows:

...

.1 .2
where Alternative B applies, Application for Interim Payment shall be made at the Period for Applications for Interim Payment stated in Alternative B in Appendix 2 up to and including the end of the Period during which the day named in the Statement of Practical

Completion occurs.
Thereafter Application for Interim Payment shall be made as and when further amounts are due to the Contractor and after the expiration of the Defects Liability Period named in Appendix 1 or on the issue of the Notice of Completion of Making Good Defects (whichever is the later) provided that the Employer shall not be required to make any Interim Payment within one calendar month of having made a previous Interim Payment.

...

30.3 .3 Not later than 5 days after the receipt of an Application for Payment the Employer shall give [*sic*] a written notice specifying the amount of payment proposed to be made in respect of that Application, the basis on which such amount is calculated and to what the amount relates and, subject to clause 30.3.4, shall pay the amount proposed no later than the final date for payment.

30.3 .4 Not later than 5 days before the final date for payment of an amount due pursuant to clause 30.3.3 the Employer may give a written notice to the Contractor which shall specify any amount proposed to be withheld and/or deducted from that due amount, the ground or grounds for such withholding and/or deduction and the amount of withholding and/or deduction attributable to each ground.

30.3 .5 Where the Employer does not give any written notice pursuant to clause 30.3.3 and/or to clause 30.3.4 the Employer shall pay the Contractor the amount stated in the Application for Interim Payment.

30.3 .6 The final date for payment of an amount due in an Interim Payment shall be 14 days from the date of receipt by the Employer of the Contractor's Application for Interim Payment."

unless an agreement to which clause 27.5.2.1 refers has been made, by notice to the Contractor determine the employment of the Contractor under this Contract and such determination shall take effect on the date of receipt of such notice.

...

27.5 Clause 27.5.1 to 27.5.4 are only applicable where clause 27.3.4 applies.

27.5 .1 From the date when, under clause 27.3.4, the Employer could first give notice to determine the employment of the Contractor, the Employer, subject to clause 27.5.3, shall not be bound by any provisions of this Contract to make any further payment thereunder and the Contractor shall not be bound to continue to carry out and complete the design and construction of the Works, in compliance with clause 2.1.

...

27.6 In the event of the determination of the employment of the Contractor under clause 27.2.2, 27.2.3, 27.3.3, 27.3.4 or 27.4 and so long as that employment has not been reinstated then:

...

27.6 .2 the Employer may employ and pay other persons to carry out and complete the design and construction of the Works and to make good defects of the kind referred to in clause 16 and he or they may enter upon the site and the Works and use all temporary buildings, plant, tools, equipment and Site Materials, and may purchase all materials and goods necessary for the carrying out and completion of the Works and for the making good of defects as aforesaid; provided that where the aforesaid temporary buildings, plant, tools, equipment and Site Materials are not owned by the Contractor the consent of the owner thereof to such use is obtained by the Employer;

...

27.6 .5 .1
Subject to
clauses 27.5.3 and 27.6.5.2
the provisions of this

Contract which require any further payment or any release or further release of Retention to the Contractor shall not apply; provided that clause 27.6.5.1 shall not be construed so as to prevent the enforcement by the Contractor of any rights under this Contract in respect of amounts properly due to be paid by the Employer to the Contractor which the Employer has unreasonably not paid and which, where clause 27.3.4 applies, have accrued 28 days or more before the date when under clause 27.3.4 the Employer could first give notice to determine the employment of the Contractor or, where clause 27.3.4 does not apply, which have accrued 28 days or more before the date of determination of the employment of the Contractor.

.5 .2

Upon the completion of the design and construction of the Works and the making good of defects as referred to in clause 27.6.2... then within a reasonable time thereafter an account in respect of the matters referred to in clause 27.6.6 shall be set out in a statement prepared by the Employer.

27.6 .6 .1 The amount of expenses properly incurred by the Employer including those incurred pursuant to clause 27.6.2 and of any direct loss and/or damage caused to the Employer as a result of the determination;

.6 .2 the amount of any payment made to the Contractor;

.6 .3 the
total amount which would
have been payable for the
Works on due completion in
accordance with this
Contract.

27.6 .7 If the sum of the amounts
stated under clauses 27.6.6.1 and 27.6.6.2
exceeds or is less than the amount stated
under clause 27.6.6.3 the difference shall be
a debt payable by the Contractor to the
Employer or by the Employer to the
Contractor as the case may be."

The agreed facts

[12] Various matters are not in dispute. By Clause 4 of the contract Messrs Robinson Low Francis were to be agents of the defenders for the purpose of receiving or issuing applications or notices under any of the conditions of the contract. The pursuers duly commenced the works to be carried out under the contract. On 2 May 2003, following the procedure in Clause 4, the pursuers submitted to the defenders' said agents an application for *interim* payment for the work done by them from the time of a previous application for *interim* payment down to 30 April 2003. On the same day, Messrs Robinson Low Francis issued a valuation certifying that the sum in which they valued, at the rates and prices provided for in the contract, the work done by the pursuers, between the date of the previous *interim* certificate and 30 April 2003, was £396,630, exclusive of VAT. A copy of that valuation was issued to the pursuers, who thereupon invoiced the defenders for payment of that sum, which in the circumstances attracted no VAT. No notices were served by the defenders, or anyone on their behalf, in terms of Clause 30.3.3 or 30.3.4 of the contract. The final date for payment in terms of Clause 30.3.6 was 16 May 2003.

[13] On 22 May 2003 the board of directors of the pursuers invited the Bank of Scotland to appoint a receiver or receivers of the whole property and undertaking of the pursuers, and on the same day the bank appointed such receivers. On 30 May 2003 the defenders, by notice in terms of Clause 27.3.4, determined the employment of the pursuers. The earliest date when the defenders could have done this was 22 May 2003.

The issues between the parties

[14] The position of the pursuers before the Lord Ordinary was that the final date for payment of the sum sued for was 16 May 2003, that it became overdue on 17 May 2003, and nothing which happened thereafter could affect their right to receive payment or entitle the defenders to withhold payment. The defenders contended that the payment sought by the pursuers had accrued within the period of 28 days before the receivership. Accordingly, by virtue of Clause 27.6.5.1 of the contract the sum sued for was not due. The defenders had proceeded with the contract work after determination. Clause 27.6.5.2 required an account to be drawn up at completion, and the sum sued for fell to be included in that account. In terms of Clause 27.6.7 the debt (if any) due to or by either party fell to be determined by that account. The defenders also made averments and tabled a plea-in-law to the effect that the sum sued for was not due by operation of law, applying the principle of balancing accounts in bankruptcy, but no submission was advanced to this effect. The task of the Lord Ordinary was, therefore, to consider the relevant provisions of the contract and of the 1996 Act, with such assistance as he could derive from previously decided cases.

Cases referred to

[15] Of the cases referred to before the Lord Ordinary and before us, three require particular mention. In the first of these, *SL Timber Systems Ltd v Carillion Construction Ltd* 2002 S.L.T. 997, suppliers of structural timber kits raised an action for payment of three sums allegedly due by virtue of decisions made by an adjudicator, in respect of three contracts for the supply and erection of kits for the defenders. The adjudicator was asked to determine whether the defenders had failed to give an effective notice of intention to withhold payment and, if so, whether they were obliged to pay the sums claimed. Lord Macfadyen, sitting in the Outer House of the Court of Session, stated in para.2 of his opinion, at p.998, that in each case the contract did not comply with the requirements of sub-sections (2) and (4) of section 108 of the 1996 Act, and consequently the adjudication provisions of the scheme applied. The adjudicator concluded that there was no timeous notice under section 110(2), or therefore in terms of section 111, and that the effect of that finding was that the sums claimed were due. The defenders submitted that the adjudicator acted in excess of his jurisdiction. Lord Macfadyen held *inter alia* that the adjudicator erred by conflating his consideration of sections 110 and 111, as failure to give a section 110(2) notice did not to any extent preclude dispute about the sum claimed and that, despite the absence of a timeous notice of intention to withhold payment, the burden remained on the claimant to show that he was entitled under the contract to receive the payment he claimed; if he did so, he was protected by the absence of a section 111 notice from any attempt by the other party to withhold all or part of the sum due on the basis that some separate ground justifying that course existed.

[16] In respect of the last point, his Lordship gave his reasons for so holding in para.22 at p.1003:

"In my opinion, the absence of a timeous notice of intention to withhold payment does not relieve the party making the claim of the ordinary burden of showing that he is entitled under the contract to receive the payment he claims. It remains incumbent on the claimant to demonstrate, if the point is disputed, that the sum claimed is contractually due. If he can do that, he is protected, by the absence of a s.111 notice, from any attempt on the part of the other party to withhold all or part of the sum which is due on the basis that some separate ground justifying that course exists. It is no doubt right, as the adjudicator pointed out, that, if the section did require a notice of intention to withhold payment as the foundation for a dispute as to whether the sum claimed was due under the contract, it would be relatively straightforward for the party disputing the claim to give such a notice. But that consideration does not, in my view, justify ignoring the fact that the section is expressed as applying to the case where an attempt is made to withhold a sum due under the contract, and not as applying to an attempt to dispute that the sum claimed is due under the contract. Nor, in my view, is there merit in the adjudicator's concern that acceptance of the defenders' construction of s.111 would render the 1996 Act largely ineffective. I see no difficulty for an adjudicator in reaching a provisional determination of a dispute as to whether the sum claimed is due under the contract. That is what, on the adjudicator's own view of the section, the adjudicator would require to do if the party disputing the claim on the basis that the sum claimed was not due under the contract gave a notice of intention to withhold payment on that ground. In my opinion, therefore, the adjudicator erred in holding that the pursuers were relieved, by the defenders' failure to give a timeous notice of intention to withhold payment, of the need to show that the sums claimed were due under the contract."

[17] *SL Timber Systems* was distinguished by Sheriff Taylor in *Clark Contracts Ltd v The Burrell Co (Construction Management) Ltd* 2002 S.L.T. (Sh.Ct.) 103. In this case, contractors sought payment from the employers under a construction contract of a sum due in terms of an *interim* certificate issued by the architect, pursuant to a provision of the contract that the

architect should from time to time issue *interim* certificates stating the amount due to the contractor from the employer and the contractor should be entitled to payment therefor within fourteen days from the date of issue of each *interim* certificate. Sheriff Taylor contrasted this provision with Lord Macfadyen's observations about the contractual provision in *SL Timber Systems*, which led him to say, in para.20 of his opinion in that case, that the words "sum due under the contract" in section 111(1) could not be equated with the words "sum claimed". The section was not, in Lord Macfadyen's opinion, concerned with every refusal on the part of one party to pay a sum claimed by the other. It was concerned, rather, with the situation where a sum was due under the contract and the party by whom that sum was due sought to withhold payment on some separate ground.

[18] Having made this distinction, Sheriff Taylor said, at p.105 I-L:

"There was no dispute that the architect had issued an interim certificate. It therefore seems to me that the defenders became entitled to payment of the sum brought out in the interim certificate within 14 days of it being issued. In my opinion that is an entitlement to payment of a sum due under the contract. In order to reach the figure in the interim certificate one has made use of the contractual mechanism. To use the words deployed by Lord Macfadyen in para 20, the issue of an interim certificate was the occurrence of 'some other event on which a contractual liability to make payment depended'. This situation falls to be contrasted with the position in *SL Timber Systems* where, before the adjudicator, there had been no calculation of the sum sued for by reference to a contractual mechanism and which gave rise to an obligation under the contract to make payment. There had been no more than a claim by the pursuers which claim had not been scrutinised by any third party. Thus, in my opinion, if The Burrell Co (Construction Management) Ltd wished to avoid a liability to make such payment because the works did not conform to the contractual standard they would be withholding payment of a sum due under the contract. In order to withhold payment they would require to give a notice in terms of s.111(1) of the Act. No such notice was given.

The interim certificate is not conclusive evidence that the works in respect of which the pursuers seek payment were in accordance with the contract (see cl 30.10). That however does not preclude the sum brought out in an interim certificate being a sum due under the contract. The structure and intent of the Act, as I understand it, and accepted by the solicitor for the defenders, is to pay now and litigate later."

[19] The third case was a decision of the Court of Appeal in England, *Rupert Morgan Building Services (LLC) Ltd v Jervis etc.* [2003] E.W.C.A. Civ. 1563, [2004] B.L.R. 18. In this case, the contract provided for the issue by the architect of *interim* certificates on a 14 day basis and that "the employer shall pay to the contractor the amount certified within 14 days of the date of the certificate, subject to any deductions and set-offs due under the contract." The architect issued an *interim* certificate in a sum, part of which was disputed by the defendants, who failed to issue a timeous notice of intention to withhold payment. The Court of Appeal held that in this standard form contract, the sum due was determined by the certificate, rather than the actual work done. The certificate might be wrong, but, in the absence of a withholding notice, section 111(1) of the 1996 Act operated to prevent the employer from withholding the sum due. Jacob L.J. said, in para.11, that the sum was determined by the certificate. He went on:

"So it is not the actual work done which either defines the sum or when it is due. The sum is the amount in the certificate. The due date is 14 days from certificate date. The certificate may be wrong - the architect may (though this is unlikely because he will be working from the builder's bill) have missed

out work done (which would operate against the contractor) or he may have included items not in fact done or items already paid for (which would operate against the client). In the absence of a withholding notice, section 111(1) operates to prevent the client withholding the sum due. The contractor is entitled to the money right away. The fundamental thing to understand is that section 111(1) is a provision about cash-flow. It is not a provision which seeks to make any certificate, interim or final, conclusive. Analysed this way one sees that there is something inconsistent about the clients' argument here. Their duty to pay now and the sum they have to pay arise only because of the certificate. Yet they wish to ignore the certificate to reduce the amount they have to pay."

He referred to Sheriff Taylor's analysis in *Clark Contracts*, which he said "casts a flood of light on the problem", so that "all this becomes blindingly clear". He referred to the Sheriff's distinction of *SL Timber Systems*, where there was no architect or system of certificates, but the builder simply presented his bill for payment. That in itself did not make any sums due: what, under that contract, would make the sums due was just the fact of works having been done, so no withholding notice was necessary in respect of works not done - payment was not due in respect of them. Jacob L.J. went on, in paras.14 and 15:

"Sheriff Taylor's analysis, once articulated, is obviously right. And it has a series of advantages:

(a) It makes irrelevant the problem with the narrow construction - namely that Parliament was setting up a complex and fuzzy line between sums due on the one hand and counterclaims on the other - a line somewhere to be drawn between setoff, claims for breach of contract which do no more than reduce the sum due and claims which go further, abatement and so on.

(b) It provides a fair solution, preserving the builder's cash flow but not preventing the client who has not issued a withholding notice from raising the disputed items in adjudication or even legal proceedings.

(c) It requires the client who is going to withhold to be specific in his notice about how much he is withholding and why, thus limiting the amount of withholding to specific points. And these must be raised early.

(d) It does not preclude the client who has paid from subsequently showing he has overpaid. If he has overpaid on an interim certificate the matter can be put right in subsequent certificates. Otherwise he can raise the matter by way of adjudication or if necessary arbitration or legal proceedings.

(e) It is directed at the mischief which section 111(1) was aimed at. This mischief is mentioned in *Keating*. A report called the Latham report had identified a problem, namely that 'main contractors were abusing their position to wrongfully withhold payment from sub-contractors who were in no position to make any effective protest'. Actually the provision has gone further than just dealing with the position between main and sub contractors since it covers the position between client and main contractor too - but the main contractor will need paying himself so he can pay the sub-contractor. And he may have his own cash flow needs too. Incidentally section 109 (requiring stage payments for long contracts) is part of the same legislative policy.

15. The principal disadvantage of the statutory scheme from the client's point of view is that if he has overpaid he is at risk from insolvency of the builder. But the risk is one which he can avoid by checking the certificate and giving a timeous withholding notice. No doubt a good architect would inform a lay client about the possibility of serving such a notice - indeed the architect may (I express no opinion) have a duty to do so. Moreover the client may (again I express no opinion) have a remedy against the architect if the latter negligently issues a certificate for too much."

Submissions of counsel before the Lord Ordinary

[20] Before the Lord Ordinary, the position of the defenders and the third parties as to the effect of Clause 27.6.5.1 and 27.6.5.2 was that, while the pursuers were entitled to demand payment of sums which had become due and which had accrued to them for at least 28 days before 22 May 2003, i.e. the first day upon which the defenders could have given the necessary notice, payment of sums which had not become due and had accrued to the contractor within that period could no longer be demanded by the contractor. The sum which the pursuers sued for in the present case had not accrued to them at least 28 days before the first day on which notice of determination by the defenders could have been given. That was, therefore, a sum, payment of which the pursuers were not entitled to sue for, because of the provisions of Clause 27.5.1. Having regard to the provisions of Clause 27.6.2, under which the defenders might employ and pay other persons to carry out and complete the construction of the works, and of Clause 27.6.7, there required to be a balancing exercise to arrive at the sums due to the pursuers by the defenders or by the pursuers to the defenders, as the case might be.

[21] Before the Lord Ordinary, senior counsel for the pursuers accepted that, if the question as to the pursuers' entitlement to be paid the sums sued for under the *interim* certificate turned on an analysis of the contractual provisions, then he was not in a position to contradict the construction and the effect of the provisions which the defenders and the third parties advanced. The position was however altered by the provisions of the 1996 Act. Clause 27 of the contract operated as a suspension of payment, until the balancing exercise provided for under that clause had been gone through, and the netting off of cross claims had been processed. That was, in effect, providing for a scheme for withholding payment. The defenders did not aver that any effective notice of intention to withhold payment of the sum in question, in accordance with the provisions of section 111, had been given by them. That being so, the effect of the statutory scheme was that the defenders could not withhold the payment in question. Clause 27 had to be read so as to avoid conflict with section 111, if possible. If that was not possible, the relevant provisions of clause 27 had to be struck down.

[22] The response of the defenders and the third parties to this argument was that the statutory provisions left the parties free to determine, as a matter of contract, what sums were due under the contract and in what circumstances. In the present case, the parties had determined, by agreement, that even if a sum was due before a receiver was appointed to the pursuers then, if the contract was subsequently determined by the defenders, as a result of the appointment of the receiver, by virtue of a notice given by the defenders in terms of Clause 27.3.4, the only remaining sums due and payable thereafter were those provided by virtue of Clause 27.6.5.1. The statutory provisions had not restricted the parties' freedom to contract to that effect. In respect of the metes and bounds of the provision contained in section 111, reference was made to the passage in the opinion of Lord Macfadyen in *SL Timber Systems* quoted above. This, it was submitted, pointed to the fact that section 111 was not concerned with prescribing what sums were *due* under the contract. That was a matter which the parties to the contract had themselves had to provide for. A withholding notice in terms of section 111 could not have been issued timeously, in the present case, because the insolvency of the pursuers occurred immediately after the expiry of the period during which such a notice should have been issued. This practical problem, in itself, pointed against the approach contended for by the pursuers.

[23] For the pursuers, it was submitted that in seeking to operate the provisions of Clause 27, the defenders were creating, in effect, a security fund to protect themselves in the light of the pursuers' insolvency. The right to do this had, it was submitted, been swept away by the legislative provisions. Ultimately the question in the present case was whether, notwithstanding the provisions of section 111 of the 1996 Act, the parties, by virtue of the provisions of the contract, remained free to alter an agreed date of payment, of a sum certified to be payable under the terms of the contract, to another date, in the light of the determination of the contract.

The decision of the Lord Ordinary

[24] The decision of the Lord Ordinary was set out in paras. 12 and 13 of his opinion, which were in these terms:

"[12] I am satisfied that the pursuers' case is irrelevant and falls to be dismissed. As has been noted, senior counsel for the pursuers accepted that, but for the provisions of section 111 of the 1996 Act, the pursuers would not have been entitled to claim the payment of the sum in question in these proceedings, since the effect of clause 27 and the notice of determination of the contract issued by the defenders was that, as a matter of contract, the employer was not bound to pay the sum in question and that questions of further payment were to be resolved under the balancing exercise provided for in clause 27. The question was, then, whether the provisions of section 111 subverts these contractual arrangements. I am satisfied that the provisions of section 111 do not have that effect. Section 109, section 110 and section 111 of the 1996 Act are, in my judgment, concerned with, and directed, at cash-flow questions, arising during the course of a continuing, non-determined construction contract. I agree with the defenders, and third party, that the provisions of clause 30 reflect the requirements of section 110 and section 111. Clause 27, however, is concerned, with a quite different situation i.e. where the contract is legitimately determined by the employer. In my opinion, the legislative provisions were not intended to regulate that situation. That situation is one for which the parties themselves have legislated and their freedom of contract in that respect has, in my judgment, not been affected by the legislative provisions. The parties' continuing freedom of contract is expressly recognised in section 109(2) and, even more importantly, for present purposes, in section 110(1) where it is provided as follows: "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*." (My emphasis)

[13] Putting the matter another way, in the present case, the parties were free to agree that the original date for payment of sums due under the contract, could be altered in the event of the contract being determined so that "the final date for payment" of the sum in question, has not, by reason of the contractual provisions yet arrived. In that situation section 111 upon which the pursuers base their case has no relevance. For the foregoing reasons I will sustain the defenders' first plea-in-law and the third party's first plea-in-law and dismiss the action."

Submissions for the parties before us

[25] At the hearing of the reclaiming motion, senior counsel for the pursuers submitted, in the first place, that the Lord Ordinary fell into error in his treatment of the issue of freedom of contract in relation to the 1996 Act, in the context of which freedom of contract was heavily restricted. If freedom of contract were to remain uninhibited by the Act, it would be pointless, for contractors would simply contract for the waiver of the provisions of the Act and thus render it a dead letter. On its true construction the Act prohibited freedom of contract

save to the extent that it expressly permitted it. Sub-section 109(2) allowed the parties only to agree the instalments or stage payments which would fall due, and the interval to elapse before they became due following the last payment. The intention underlying the legislation was to secure cash flow. This was not less important to the contractor in receivership, than to the contractor in danger of it. The language of the statute did not suggest that its provisions were restricted to contracts which were on foot and undetermined.

[26] Secondly, it was submitted that the Lord Ordinary erred in construing Clause 27 as an example of what section 110(1) left the parties free to decide. That sub-section allowed the parties to decide a period of time that might elapse before a sum which had become due reached its final date for payment: and the parties had provided for this period in Clause 30.3.6. Clause 27 did not select a final date for payment. It sought to relieve the employer of the obligation to make payment under Clause 30.3.5 until the works had been completed. Insofar as it entitled the employer to withhold sums due and payable, in the absence of notices required by the 1996 Act, this was consistent with the Act. What the defenders were seeking to do was to withhold money, although the final date for payment had passed. The policy of the Act was clear and should not be thrown over by a hard case.

[27] Senior counsel for the pursuers repeated the concession he had made before the Lord Ordinary, saying there was no issue that if the 1996 Act had not been passed, the pursuers could not recover the sums sued for.

[28] Senior counsel for the defenders submitted that the Lord Ordinary had correctly decided that the parties had agreed, in terms of Clause 27, that the final date for payment was to be the date on which a positive balance was found to be due to the pursuers after the works had been completed. Clause 27 was not disapplied or otherwise struck at by the 1996 Act. Counsel said that he did not go so far as the Lord Ordinary in arguing that sections 109 to 111 of the 1996 Act did not apply to a situation in which "the contract is legitimately determined by the employer". Clause 30.3.6 had to be read in light of Clause 27, which had a retrospective effect. If the contractor was not entitled to be paid until the balancing exercise following completion of the works produced a positive balance, it could not be said that the final date for payment was any earlier. To put it another way, once the employment of the contractor had been determined, following receivership, the final date for payment was *ipso facto* changed to a date on which a positive balance was found to be due to the contractor, if ever. The final date for payment was changed by virtue of the contractual provisions: the possibility of this change was inherent in the provisions of Clause 27. In terms of section 109(2) of the 1996 Act the parties could regulate the circumstances in which a payment became due in the event of a receivership. There was no statutory obstacle to the parties' agreeing that in the event of determination of the employment of the contractor on the grounds of receivership, the period between which a sum became due and the final date for payment was that necessarily indefinite period provided for by Clause 27.6.5.2. The issue was not when a sum became due, but what was the final date for payment. The Lord Ordinary had correctly held that the parties were free to agree that the original date for payment of sums due under the contract could be altered and that in the circumstances of the present case the final date for payment of the sum in question had not yet arrived.

[29] Senior counsel for the third parties adopted the submissions of senior counsel for the defenders, except that he submitted that there was force in the Lord Ordinary's approach to sections 109 to 111 of the 1996 Act. These were concerned with an ongoing contract. If the employer was not entitled to withhold payment in circumstances such as the present, there was nothing for the employer to be able to use to balance what would almost inevitably be greater costs incurred in completing the works.

Discussion

[30] We have to consider, first, whether the Lord Ordinary was correct in holding that "the legislative provisions were not intended to regulate" the situation "where the contract is legitimately determined by the employer" in terms of Clause 27 of the contract. What

Clause 27.3.4 provides for, however, is not determination of the contract (a concept which is not further explained by the Lord Ordinary), but determination of the employment of the contractor under the contract. Clause 27 contains a number of provisions which show that the contract is intended to remain in force after the determination of the employment of the contractor and to regulate the rights and obligations of the employer and contractor after that event. Not least of these are the provisions of Clause 27.6.5.1 and 27.6.5.2. Of the authorities referred to, we agree that *SL Timber Systems* can be distinguished because the contractual arrangements were materially different from those in the present case. In that case, there was no more than a claim for payment, without a system of certification which would determine the sum due. We agree with the approach to this issue in *Clark Contracts* and *Rupert Morgan Building Services*. We agree also with the view expressed in the latter case that section 111(1) is a provision about cash flow, with the advantages set out in the passage in the opinion of Jacob L.J. quoted above.

[31] This being so, the question which next arises for consideration is whether, bearing in mind that section 111(1) is a provision about cash flow, the statutory provisions nevertheless permit the result contended for by the defenders. We proceed for this purpose on the assumption that, in the absence of the statutory provisions, Clause 27.6.5.1 of the contract would, in the circumstances of the present case, entitle the defenders to withhold payment of the sum sued for until the completion of the works and the preparation of the account provided for by Clause 27.6.5.2. This is in accordance with the concession made by senior counsel for the pursuers, and with the assumption upon which the parties presented their submissions both before the Lord Ordinary and before us.

[32] Senior counsel for the defenders submitted that, on a proper construction of the contract, Clause 27 had the effect of altering retrospectively the final date for payment of the sum sued for. He did not, however, argue that, if this submission was not accepted, section 111(1) had no application in the circumstances of the present case. Senior counsel for the third parties sought to argue otherwise, submitting that section 111(1) did not apply in the present case. A number of considerations, however, point away from this as being the proper construction of the contract. The contract complied with section 109(1) by providing in Clause 30.1.1 for the making of *interim* payments. By section 109(2) the parties were free to agree the amounts of the payments and the intervals at which, or circumstances in which, they became due, and made appropriate provision for this in Clause 30.1.2. The parties complied with the requirements of section 110(1) by providing an adequate mechanism for determining what payments became due under the contract, and when, and what was to be a final date for payment in relation to any sum which became due, in terms of Clauses 30.3.3 to 30.3.6. While, in terms of section 110(1), they were free to agree how long the period was to be between the date on which a sum became due and the final date for payment, by Clause 30.3.6 they provided that it should be 14 days from the date of receipt by the defenders of the pursuers' application for *interim* payment. It is not in dispute therefore that, in the circumstances of the present case, the final date for payment of the sum sued for was 16 May 2003. Not only was that sum overdue for payment after that date, the pursuers could have taken immediate steps to enforce payment. In our opinion, even if the statute permitted it, it would require a very clear contractual provision to have the effect, contended for by the defenders, of retrospectively altering the final date for payment and of depriving the pursuers of a right which had already accrued to enforce immediate payment. There is no such provision in Clause 30, or indeed in Clause 27. Clause 30.3.6 does not provide that the final date for payment is subject to alteration in the events provided for by Clause 27, and indeed all that Clause 27.6.5.1 provides is that the provisions of the contract which require any further payment to the contractor shall not apply, with the exception of amounts which had accrued 28 days or more before the date of determination of the employment of the contractor. Clause 27.6.5.2 goes no further than to provide for the preparation of an account after the completion of the works. The obvious difficulty in seeking to impose on these provisions the construction contended for by the defenders is that it is impossible to discover from them what the final date for payment would then be, and indeed it might never arrive. What these provisions appear to us to purport to do is to permit the employer to withhold, in

certain circumstances, an amount due after the final date for payment thereof, not to alter retrospectively the final date for payment. If this be, as we hold it is, the correct interpretation of these provisions and if, as we have already held, sections 109 to 111 of the 1996 Act continue to apply even after the employment of the contractor has been determined by the employer, the conclusion is inescapable that section 111(1) applies to prevent the defenders from relying on Clause 27.6.5.1.

[33] This is a conclusion which is consistent with the view that section 111(1) is a provision about cash flow. The sum sued for represents payment for work which had already been done by the pursuers, no doubt with the financial support of the Bank of Scotland at whose instance the receivers were appointed shortly afterwards. In many cases, not only will there be bankers with an interest in a contractor's cash flow, there will be sub-contractors awaiting payment. Inevitably, where a contractor becomes insolvent, there will not be enough money to go round and losses will have to be borne. In our opinion Parliament has provided quite clearly that in circumstances such as the present the losses should be borne by the defenders as the employer under the contract, hence the provisions of section 111(1). The final date for payment of the sum sued for under the contract had passed without any effective notice of intention by the defenders to withhold payment, so the defenders were prohibited from withholding payment thereafter.

Result

[34] For these reasons we shall allow the reclaiming motion and recall the interlocutor of the Lord Ordinary. It was not in dispute that, if we so decided, the pursuers were entitled to decree *de plano* as concluded for. We shall accordingly repel the pleas-in-law for the defenders and third parties, sustain the pleas-in-law for the pursuers, and grant decree for payment to the pursuers by the defenders of the sum of £396,630, together with interest thereon at the rate of 83/4% per annum from 17 May 2003 until payment.