

Insights

A FINAL ACCOUNT PROBLEM – JSM CONSTRUCTION V WESTERN POWER

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SUMMARY

The final account is normally a wrap-up of the contractor's valid claims for extra payment. It's particularly helpful if claims were not submitted or assessed as works progressed. So, what happens if the contract doesn't have a final account procedure but there are claims outstanding once the works are finished? Can a final account procedure be implied under **section 110(3)** of the Construction Act 1996

This was one of the questions the TCC faced in the recent case of **JSM Construction v Western Power**.

What happened – a quick recap

Western Power (WP) contracted with JSM to install two cables in Birmingham under a lump sum contract described as a "pro forma" "Ad Hoc Agreement for Underground Works" amended by WP's "detailed terms".

The contract provided that interim payments would apply but provided no further details. The parties agreed that retention would be 5% of the contract price. Unfortunately, the contract price, the contract commencement date and the contract period were left blank. No provision was made for a final account regime although there was a mechanism for claiming and valuing variations and extra cost during the progress of the works.

The problem

During the works, JSM submitted eleven applications for payment. It submitted a twelfth payment application for around £1.8 million (which it described as its "final application") approximately 19 months after application no. 11. The sum was calculated based on a re-measurement of the works.

WP refused to pay the final balance arguing that JSM's contractual entitlement was only to a series of interim payments (as opposed to a "final" payment), there was no implied term entitling JSM to raise a final invoice and the claim was therefore bound to fail.

What happened next?

JSM issued proceedings to recover the sums it claimed were due, raising various arguments including that:

WP's design of the works was incomplete and the pricing schedule therefore wasn't suitable for valuing the constructed works; and

The payment regime was inadequate as there was no provision for a final account and so the final account provisions in the Scheme for Construction Contracts 1998 (Scheme) should be implied into the contract.

WP responded by seeking to strike-out the claim or alternatively enter summary judgment against JSM.

The court dismissed JSM's application. The court decided it was a fact-sensitive dispute and whether a term should be implied into the contract to allow JSM to claim a reasonable sum for its works couldn't be decided at an interim hearing.

While the court did not make any final pronouncements, it made a number of interesting observations on how to determine the adequacy of a contractual payment mechanism that did not include final account provisions. Let's explore these in more detail below.

A payment mechanism does not need a final account provision to be adequate

The court explained that the parties' only obligation is to comply with the Construction Act 1996 (Act) and provide an "adequate mechanism" for determining what payments become due and when. Even if the payment mechanism does not have one or more of the payment elements set out in the Scheme, it can still be "adequate". In other words, a contract does not **need** to have a final account mechanism to be Act-compliant.

The court gave the example of a simple contract whereby the parties agree a fixed price of £1 million, payable by five equal stage payments. The court explained that the fifth stage payment might properly be described as the final payment without it requiring any complex exercise of measurement or valuation.

In addition to the court's observations, a further point worth noting is the parties' discussion of whether a contract needed to include a final account mechanism by reference to standard forms such as JCT, FIDIC and NEC.

The JCT and FIDIC suite of contracts provide a mechanism and timeline for assessing the final account and payment to the contractor. The assessment involves a process of calculating and

agreeing adjustments to the contract sum to determine the value of the final payment.

The adjustment considers a whole raft of things including variations, loss and expense and contra charges. Even if the process starts out amicably it often becomes time consuming, adversarial and expensive if the parties cannot agree the final account. However, it is a final opportunity for the contractor to claim a reasonable and fair sum for the works it has undertaken. It is also a lifeline for the contractor who didn't claim variations or additional costs as works progressed.

In theory, if parties adjust the contract sum throughout the works, as and when variations are instructed or delays encountered, there are fewer issues to argue about at the end of the project. JSM argued that provisions as to a final account are key and customarily to be found in standard form construction contracts. Therefore, the lack of their inclusion in a contract would render the payment regime "inadequate" and necessitate the implication of such a regime under the Act.

However, WP, citing the NEC3 form as an example, responded that nothing in sections 109 and 110 of the Act required the parties to agree a final payment provision. As users of the NEC3 will know, there's no final account mechanism. It's assumed that the final account is adjusted as the project proceeds using the compensation event procedure. A "rolling final account" is all good in theory but doesn't always work in practice and NEC4 introduced a final account mechanism.

There is clearly industry demand for a final account mechanism, but, following the court's judgment in this case, it is clear that it is not "necessary" for an adequate payment mechanism under the Act.

The court must exercise a "value judgment" in assessing whether a payment mechanism is adequate

The court observed that whether a payment mechanism is "adequate" requires the court to:

"Take a holistic view of the overall mechanism for payments under a contract and to ask whether such mechanism is adequate for determining what payments become due and when."

This is a question of fact. It will depend on the individual circumstances including the other terms of the contract.

Mr Justice Pepperall referred to the unreported Scottish case of *Mair v Mohammed Arshad* (2007), which provided the following guidance:

"Large complex construction operations will no doubt require complex highly structured mechanisms. Equally, simple, straightforward construction operations may be satisfactorily served by a very simple mechanism."

Therefore, what constitutes an "adequate payment mechanism" is likely different for a relatively small lump sum contract and a large complex infrastructure project. In this application, Mr Justice Pepperall noted that if the contract was one for a fixed price with a mechanism for claiming and

valuing variations then it is arguable that a simple payment mechanism that provided for monthly stage payments throughout the works that were commensurate with progress made might well be adequate for establishing what payments were due.

Parties to a contract should not be using the Act or the Scheme to correct a bad bargain

The court noted that a payment mechanism like that used by JSM and WP could:

"... put the parties under considerable pressure in valuing variations or extra costs payable by reason of unforeseen circumstances,"

but made the point that "even if the mechanism is inconvenient, the purpose of the Act is not to save a party from an imprudent deal".

In short, the message is that litigants should not be using the Act or the Scheme to correct a bad bargain or to save them from failing to agree additional time and/or costs as the project proceeds.

Where does this leave us?

If the contract does not provide for a final account mechanism or payment, it does not follow that one may be implied, particularly where the contract provides for the valuation of works through the interim payment cycle. In such circumstances, the onus is on the parties to ensure that monthly interim applications are accurate, commensurate with actual progress and reflect any valid claims. The courts will be reluctant to rescue them from a failure to properly administer their contract in accordance with its terms.

This [article](#) first appeared on the Practical Law Construction blog dated 8 March 2021.

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