Restoring fairness to the process: another episode in the smash and grab adjudication saga

DENTONS

May 1, 2018

In his final case in the Technology and Construction Court (TCC) before taking up his new position as a Court of Appeal judge, Coulson J has tipped the balance away from contractors in smash and grab adjudications.

The harsh 2011 changes to the payment terms under the Construction Act mean that employers who disagree with a contractor's valuation towards the end of the project (but who do not serve a valid pay less notice) must pay the sum stated as due in the contractor's payment application. If they do not, contractors can refer the non-payment to adjudication where they are very likely to obtain a decision in their favour ordering the employer to pay – a decision that the TCC will enforce.

An adjudication decision in these circumstances gives the contractor a distinct advantage ahead of the final account valuation process – it places the (potentially large) pot of disputed money in the contractor's hands.

In Grove, the employer (Grove) had served a pay less notice but the defendant (S&T) had claimed it was invalid. An adjudicator had agreed with S&T. Both parties had started proceedings in the TCC: S&T to enforce the adjudicator's decision; Grove to obtain declarations that the pay less notice was valid and that it could go to an adjudication to ascertain the true value of the sum payable.

The facts

Grove had engaged S&T to design and build a hotel at Heathrow Terminal 4 using the JCT Design and Build Contract 2011. Grove disagreed with S&T's interim application no. 22 (IA22) (which was approximately £14 million higher than Grove's previous valuation) and served a pay less notice. That notice referred to calculations Grove had set out in an earlier email.

S&T argued the pay less notice was invalid because it should have specified the calculations within the notice itself. An adjudicator agreed (meaning Grove would have to pay up) but, in the meantime, Grove had issued TCC proceedings for declarations that the pay less notice was valid and, if it was found invalid, that it could adjudicate the true value of IA22.

Here's a snapshot of each of the main issues considered by Coulson J.

Can a pay less notice be valid if it refers to and relies on calculations set out in other documents?

In short, yes, provided the reference is clear and the document referred to is clearly identified. Coulson J took a practical approach – S&T could fully understand from the reference how Grove's valuation was calculated and, as a matter of principle, there could be no objection to this method.

When an employer disputes a sum applied for but fails to serve a valid pay less notice, thereby triggering the requirement to pay up on the contractor's payment application, can it refer the question of the true value of that payment to adjudication?

Again, Coulson J's answer to this question was yes based on six reasons. In summary:

1. Just as a court has an inherent power to decide on the true value of certificates/notices/applications (including opening up, reviewing or revising them), so does an adjudicator.
2. Neither the Construction Act* nor the Scheme** limit the nature, scope or extent of disputes referable to adjudication.
3. Disputes on the validity of a pay less notice and its true value involve separate issues. Where the former is dealt with by an adjudicator, the second is a separate issue and can be referred to adjudication separately.
4. There is a contractual and fundamental difference between "the sum due" and "the sum stated as due". If, having failed to serve a valid pay less notice, the employer is obliged to pay "the sum stated as due" (by the contractor), it can still refer to adjudication the true value of the contractor's application (i.e. "the sum due" under the contract).
5. It would be wrong in principle, unjustifiable, unfair and unequal to stop an employer from challenging "the sum stated as due" when a contractor can make such a challenge as soon as the employer serves the pay less notice.
6. The contract treats – and the parties, adjudicators and courts should also treat – interim and final applications and payments in the same way. Whether what is in dispute is an interim payment or a final payment, the employer has the right in principle to refer to adjudication the dispute about the true valuation (provided it first pays the sums stated as due).

Coulson J found support for his conclusion in various Court of Appeal judgments, but did not agree with the TCC's reasoning in *ISG Construction Ltd v. Seevic College* (2014) and *Galliford Try Building Limited v. Estura Limited* (2015). In these cases, the judge had held that the employer's failure to serve the pay less notice amounted to its deemed agreement to "the sum stated as due" in the contractor's payment application. Having thus "agreed" the sum, its true value under the contract was not in dispute and the employer could not, therefore, refer that issue to adjudication until after a final determination. In the meantime, the employer had to pay up.

Coulson J found there was no factual basis for the employer's deemed agreement; the approach in ISG and Galliford was an unjustified and unnecessary complication; and the TCC's conclusion was contrary to the Court of Appeal authorities.

Practical points

- Employers can, when drafting a pay less notice, refer to and rely on calculations set out in other documents. Those who choose to take this approach rather than setting out the calculations within the payment notice take a risk that their references may be inadequate or misunderstood. Ensure both the references and the calculations referred to are clear.
- An employer who disagrees with the contractor's valuation must serve a pay less notice if it thinks less is payable than stated as due on the payment application.
- If no or an invalid pay less notice is served, the employer must pay to the contractor the sum stated as due in the contractor's payment application.
- If the employer disagrees with the contractor's valuation but does not serve the pay less notice, it can start a fresh adjudication to determine the true value payable to the contractor. However, the employer must first pay the whole of the sum stated as due – it cannot set off what it believes to be an overvalue. A failure to pay up before referring the issue of the true value owed to adjudication might mean that the second adjudicator does not have jurisdiction

to decide. (This requirement to wait until after making payment before referring the issue to adjudication does not, however, seem to fit comfortably with an employer's right to adjudicate "at any time".)

- Where the employer has disputed the valuation[s], the contractor should think twice before starting a smash and grab adjudication. The money might have to be repaid in a relatively short space of time following a second , "true value" adjudication. The fact that there is no contractual provision to repay any overpayment is irrelevant – the second adjudicator has power to order that repayment.

S&T has been given leave to appeal: expect more judicial direction on smash and grab adjudications in the near future.

A full version of our case report on *Grove* is due to appear in *Construction Law* shortly.

A further issue in Grove (unrelated to smash and grab adjudications) – on the timing of liquidated damages notices

Coulson J dealt with another issue in *Grove* which is worth mentioning.

The project had been delayed, Grove had served liquidated damages notices on S&T, but S&T had taken issue with the timing of those notices.

Grove argued they had complied with the contract by serving two notices in the correct sequence: the first warning it might apply liquidated damages and the second giving notice of its intention to deduct liquidated damages. S&T took issue with the latter being served within seconds of the first.

Coulson J decided Grove's notices were compliant with the contract. The contract did not specify a period between the warning and deduction notices. Grove was not giving notice of a time period needed to remedy a default (such as is required if a termination notice is served). By the time the warning notice was served, S&T was already in culpable delay – there was no scope to rectify the delay that had already occurred. All that mattered was that Grove served the notices in the right sequence (warning then deduction notice) – which it had.

---

* Housing Grants, Construction and Regeneration Act 1996 (as amended in 2011)

** The Scheme for Construction Contracts (England and Wales) Regulations 1998 (as amended)

Your Key Contacts

Akin Akinbode
Partner, London
D +44 20 7320 3934
M +44 7585 965 482
akin.akinbode@dentons.com

Tracey Summerell
Managing Practice
Development Lawyer,
Milton Keynes
D +44 20 7320 6523
tracey.summerell@dentons.com