Adjudications on the increase

Anecdotal evidence suggests that adjudications are still on the increase. This increase is supported by the statistics in the Adjudication Society's 15th report, which shows a 5 per cent increase in adjudications in 2015/2016 in comparison with the previous year (following a 12 per cent increase in 2014/2015).

The 2014/2015 increase was partly attributable to the court's interpretation of the 2011 statutory changes to the payment notice regime (to mean that a sub-contractor/contractor is automatically entitled to the amount applied for in an interim application if the employer/main contractor has not served a pay less notice in time). This approach has resulted in many supply-chain led "smash and grab" adjudications (although recent case law has made it harder to succeed in such adjudications without showing full compliance with the technical requirements of the Housing Grants, Construction and Regeneration Act 1996 as amended by the Local Democracy, Economic Development and Construction Act 2009).

Market conditions might make it more difficult to enforce adjudication decisions

However, our recent adjudication experience suggests the steady increase may also be attributed, in part, to a hangover from the 2008/2009 recession. There have been suggestions that projects bid for during the recession, and in the slow recovery years that followed, might not have been priced on a sustainable or profitable basis – with all too familiar disputes arising as the projects near completion.

The industry's slow recovery from the recession, combined with nerves about how Brexit will affect the economy and the day-to-day running of construction businesses, is contributing to fluctuations in UK construction activity. The construction industry is heavily dependent on cash flow and, with the significant falls in UK construction output in recent months, there remains uncertainty around some projects and whether they will be put on hold or delayed. Coupled with a reduction in investment and a likely slow-down in land acquisition, it appears that contractors will find it even more competitive to get work.

Given the change in economic landscape, the likelihood of everyone in the industry holding their wallets a bit closer for the foreseeable future, and the importance of using adjudication to assist cash flow, we thought it timely to review adjudication enforcement proceedings and the effect of insolvency on adjudication enforcement. Our first article deals with the procedure involved in enforcing an adjudication. The second article considers the effect of one party's insolvency on adjudication proceedings and how to deal with it.

How do you enforce an adjudicator's decision?

How to deal with insolvency in adjudication enforcement proceedings?

Some tips
How do you enforce an adjudicator's decision?

Enforcing a successful adjudication decision or attempting to defend enforcement usually involves legal arguments, court procedures and, if it goes the distance, a hearing at court.

Those contemplating adjudication proceedings should be aware of the steps required to enforce a decision prior to bringing an adjudication in the first place. In particular, they should consider: (i) what the likelihood is of succeeding in enforcing a decision; and (ii) how likely a challenge to an adjudicator's decision (in enforcement proceedings) is to succeed.

What is the adjudication enforcement process?

Following an adjudication, the adjudicator will usually provide the unsuccessful party with seven days to pay the successful party. For the unsuccessful party, there are usually three reasons for not paying:

• to stall for time, while preparing for either another adjudication or an alternative means of recovery from the decision (possibly a court claim);

• it disagrees with the adjudicator's decision and wishes to challenge the decision by other means; and/or

• it cannot pay.

If a party does not pay, the successful party will need to enforce the decision. At this stage, the successful party should consider whether the other party can pay before incurring the costs of enforcing a decision.

The Housing Grants, Construction and Regeneration Act 1996 as amended by the Local Democracy, Economic Development and Construction Act 2009 (the Construction Act) provides for the process of adjudication, but does not provide a process for enforcement. The Technology and Construction Court (TCC) has developed a procedure which is set out in section 9 of the TCC Guide.

A successful party can usually (depending on court availability and the length of the adjudication) obtain a TCC judgment within 75 days of starting an adjudication. Most TCC judges keep time aside for urgent adjudication business. This is evidence of the TCC's support for adjudication.

Enforcement proceedings are started by issuing a claim form at court. The claim form should state that it is seeking the enforcement of an adjudicator's decision, and a timetable for directions (in the format found at Appendix F of the TCC Guide). The claim form needs to set out: the construction contract; what the adjudicator had to decide in the adjudication; the procedural rules governing the adjudication; what the decision was; the relief sought (i.e. enforcement), and the grounds for seeking that relief (i.e. that the unsuccessful party has not paid).

In addition to the claim form, the court should be given an application notice applying for summary judgment and an order for the timetable/directions for the enforcement (an example of which is found at Appendix F of the TCC Guide).

A witness statement should support the claim form and the application. The witness statement should explain the evidence relied on in support of both the summary judgment claim and the timetable/directions. This evidence should include a copy of the Notice of Adjudication and the adjudicator's decision.

A court fee is payable for the court to issue these documents and put them before a TCC judge. A TCC judge considers the application "on paper", without a hearing and without the other party knowing. The TCC judge will then make an order to deal with all the steps leading up to an enforcement hearing.

Once the applicant receives this order from the TCC, it serves it on the other party. The other party will then need to
consider whether to pay up or challenge the enforcement application. If the latter, the other party must acknowledge service, and prepare its evidence in response.

Is it worth challenging an enforcement application?

The receiving party should consider carefully whether to continue to challenge the adjudicator's decision. There are few grounds on which the TCC will refuse to enforce the decision and there is therefore a relatively small chance of a successful challenge. In many circumstances, it is better to avoid incurring the costs of the enforcement hearing (which will include its own costs and, quite probably, if the challenge fails, the other party's costs) and make an offer to settle the proceedings.

Successful challenges are unlikely because the court recognises adjudication was conceived with improved cash flow rather than justice in mind. Consequently, the TCC is reluctant to interfere with an adjudicator's decision and will generally enforce it. There are very limited circumstances in which the TCC will not enforce the decision (see below). Generally, the TCC is suspicious of parties listing a number of reasons why it should not comply with an adjudicator's decision. It often appears like a cynical last ditch attempt to avoid paying.

When will the TCC refuse to enforce an adjudicator's decision?

The TCC will only refuse to enforce an adjudicator's decision in very limited circumstances. It is worth being aware of these reasons as they are useful as a defence (if appropriate) in an adjudication.

- The adjudicator clearly had no jurisdiction. For example, maybe the adjudicator has not been properly appointed, or a dispute has not crystallised.

  Note that, for this argument to succeed, the party must have reserved the right to challenge the adjudicator's jurisdiction during the adjudication proceedings both in correspondence and in its submissions. If the party continues with the adjudication proceedings without reserving its position in relation to the jurisdictional challenge, it could be said to have waived its right to rely on it in future.

- There has been a serious breach of natural justice in the adjudication. For example, the adjudicator might have shown bias by consulting one and not both of the parties about an approach to the adjudication, or the adjudicator might have taken advice from a third party (without the parties' consent, or without informing them of the intention to do so).

- The court might "stay" the enforcement (i.e. suspend the proceedings) if the paying party is insolvent. For more on this possibility, see our next article: How to deal with insolvency in adjudication enforcement proceedings.

The narrowness of these choices makes challenging an adjudicator's decision risky: failure to succeed on these grounds will lead to the challenging party paying the successful party's costs. It is always sensible to take legal advice before resisting payment and trying to challenge an adjudicator's decision.

For more information, contact one of the team listed under Key Contacts.

How to deal with insolvency in adjudication enforcement proceedings?

Insolvency is common in the construction industry, even when the going is reasonably good. The entire supply chain is heavily dependent on cash flow to survive. It pays to be vigilant and look out for signs of potential insolvency in the
How does insolvency affect the approach to adjudication?

A company is insolvent if it is unable to pay its debts. This inability is based on a number of criteria, which include a failure to satisfy the enforcement of a judgment debt.

Adjudication decisions are binding unless the issue remains disputed and a court or arbitration tribunal later makes a final decision. A party ordered to pay a sum it disputes to a financially unstable party will understandably be nervous. In particular, it will be concerned about whether the party will still be solvent to enable recovery of that sum if it is later found not to be due (in court or arbitration).

The courts recognise this issue and various decisions have established that the insolvency of one of the parties has a dramatic effect on the adjudication enforcement process, depending on when the insolvency occurs:

- It is a common tactic for one party to threaten adjudication proceedings at the point of (the paying party's) insolvency. However, adjudication is only an effective tactic to recover money from a contractor or sub-contractor before it becomes insolvent.

- Post-insolvency, the court will not enforce the adjudicator's decision. Unfortunately for the party bringing the adjudication proceedings, if the contractor becomes insolvent during the proceedings it will have no incentive to pay up after the adjudicator issues the decision. It knows there will be no need to pay at the enforcement stage.

- If by the date of an enforcement hearing the successful party is in liquidation or is in administration, then the decision may be unenforceable.

The application of the Insolvency Rules – the net balance

Under the Insolvency Rules, where, prior to liquidation, there have been mutual credits, mutual debts or other dealings between the insolvent company and a company claiming a debt in the liquidation, an account is taken of what is due from each party to the other. Say, for example, two companies are working on two different projects, and on one project money is owed to the insolvent company, but on the other, money is owed by the insolvent company. The sums due from one company are set off against the sums due from the other. This results in a "net balance". Therefore, any individual claim each party had is replaced by a claim for the "net balance".

A dispute relating to the net balance under Insolvency Rules cannot be referred to adjudication (although the courts have come to a different view on whether a claim can be made under arbitration). It is often considered that...
Is the position different depending on whether the company is in administration or liquidation?

Administration allows for the reorganization of a company or the sale of its assets under the protection of a moratorium. This moratorium prevents creditors from taking action to enforce their claims against the company during the company’s administration. The idea of administration is to rescue the company, or its business. Liquidation occurs when the assets of a company are realised and distributed to its creditors.

- If the party is in administration, the adjudicator’s decision may be enforced. The party in administration might be able to obtain a stay (that is, a court order to delay the enforcement).

- The court will not normally order a stay if the evidence of the unsuccessful party’s current financial position is: (i) the same or similar to the financial position when signing the contract; or (ii) a consequence of the unsuccessful party’s failure to pay the sums the adjudicator decided.

It is worth noting that the court considers the circumstances in which a stay will be granted are limited. A stay is contrary to the purpose of adjudication. However, if the party is in insolvent liquidation, or it is not disputed that the contractor is insolvent, then a stay of execution will usually be granted. Adjudications against parties in weak financial positions may be better brought sooner rather than later.

Some tips:

- If the company is insolvent, think carefully before taking enforcement action.

- If the company is already in administration, or there are rumours of it struggling financially (i.e. it has not yet entered administration or liquidation), it may be beneficial to press ahead with an adjudication and obtain a decision as soon as possible. Think twice in this position, however.

- Is the company likely to enter liquidation? If yes, it may still successfully seek a stay of enforcement of a decision obtained on the basis it is unable to repay the judgment sum (for example under a final account).

- If liquidation is likely, it may be better to consider whether a commercial agreement can be reached over the sums in dispute. This will inevitably mean a compromise needs to be reached which may initially appear to be unsatisfactory. However, once a company becomes insolvent, the opportunity will have been missed to reach a commercial compromise or succeed in an adjudication. In hindsight, the commercial compromise may be better than nothing.