Fenwick Elliott

The construction law specialists

Adjudication in the credit crunch: how to make the pips squeak

by Simon Tolson

1. In this paper I shall address:

   (1) Is adjudication meeting the dash for cash?

   (2) Adjudication – a right to treat at any time

   (3) Section 11 of the Insolvency Act – administration - a trap for the unwary

   (4) Stays to enforcement and blocking moves

   (5) CVAs and enforcement

   (6) Is adjudication quick enough or too fast for comfort?

   (7) The effect of determination on the enforcement of an adjudicator's decision

   (8) Adjudication in the credit crunch: is it providing the answers?

   (9) The leapfrog from decision to Petition in a day – watch the pips go squeak

   (10) Vesting Certificates v advance payment bonds

   (11) The commonly overlooked rule in Day v McLea

   (12) The view from the Aldwych on this crunch

2. In doing so I caution at the outset that I do not attempt to look at what might finally happen in reform, repeal or annulment of the HGCRA by the desperately boring titled *Local Democracy, Economic Development and Construction Bill*. Sadly despite the huge time devoted by many lawyers and groups like TeCSA for 5 years or more to various government consultations its drafting has not eliminated the confusion that the HGCRA has given rise to in the industry ever since it came into effect between "Due Date" and "Final Date for Payment" and "sum due" and if anything the path has been two steps back and pigeon step forward.

3. Some of the amendments made me struggle to work out what is intended; in fact it was so bad it is better the devil we know. For example Section 111 (which it appears will now deal with abatement, set-off and any other deduction) does not seem to have regard to the underlying contractual entitlement. It also appears that if there is no notified sum nothing is payable! Let's just hope for one thing, that the insistence on agreements in writing is done away with.

4. I find it curious the Government has said the reason for the Bill was that:

> Extensive consultation with the construction industry has identified that while the Construction Act has improved cash flow and dispute resolution under construction contracts it is ineffective in certain key regards.

5. The key policy objectives are said to be to improve the existing regulatory framework in order to:

   (i) Increase transparency and clarity in the exchange of information relating to payments to enable the better management of cash flow;

   (ii) Encourage the parties to resolve disputes by adjudication, where it is appropriate, rather than by resorting to more costly and time consuming solutions such as litigation; and

   (iii) Improve the right to suspend performance under the contract.

6. The Government commenced consultations on the Act in 2005. The Department for Business, Enterprise & Regulatory Reform (BERR[1]) and the Welsh Assembly Government jointly published an analysis of responses to the 2007 Consultation on proposals to amend Part II of the HGCRA 1996 and Scheme for Construction Contracts (England and Wales) Regulations 1998 which led to the draft Bill published in July 2008 and amended in December as the Local Democracy, Economic Development and Construction (LDEDC) Bill setting out the proposed amendments to the Act. The Bill has now passed through the House of Lords. Lord Tope captured the views of a much wider audience when he summed up the House of Lords' view of the LDEDC Bill in 2008:

> We think that some of it is unnecessary, some of it is undesirable and much of it is well intentioned; there is also some of it with which we simply disagree. The one point on which I think we will all agree is that it leaves this House in a very much better condition than it arrived, but not yet in a pristine condition.

7. It has now gone back for consideration by the House of Commons. The Bill will be reprinted before coming back to the House of Commons for its remaining stages on 13 October 2009.

8. Therefore it is now in its final stages of going through Parliament with the Report Stage and Third Reading to go before Royal Assent.

9. However, the Government has indicated that there may need to be further consultations, so it is hard to say when any certainty when the changes will become law and delegated legislation published.

10. Time is better spent in the real world.

[1] But common to this government's proclivity to change the label on the tin like some change their underwear, on the 5th of June 2009 the Government created a new Department for Business, Innovation and Skills (BIS). The Department was created by merging BERR (created in June 2007, from the DTI) and Department for Innovation, Universities and Skills (DIUS).

(1) Is adjudication meeting the dash for cash?

11. First the home truths as seen from my eyes as a construction solicitor: getting an adjudicator's decision on money may be the difference between a party securing payment of money owed to it and ending up in a long queue of unsecured creditors.

12. Timing is everything, given:

- The downturn has been sudden and unexpected and yes, there will be a deeper cut to follow.

- The banks and other lenders have taken a very risk adverse position – we are into profound recession with green shoots rather like bum fluff on a callow youth, there is some way to go before the man steps forth. Projects with excellent prospects are struggling to obtain finance and there is a lack of balance in decisions being made.

- It started with house building, it is now right across the commercial sector. Many companies have stopped new builds and are waiting to clear existing stock before making any further decisions. People are reluctant to talk openly about the effect this is having on profit and turnover but clearly there is an adverse effect as statutory accounts are now revealing this year.

- The underlying demand for housing remains high but prospective purchasers struggle to get finance. Mortgages above 90% equity are still very difficult if not impossible to get even for lawyers and those between 70% and 90% are incurring higher fees and higher rates. Gone are applications on line and offers the next morning. This has an acute effect at the lower end of the market with first time buyers. This in turn has triggered a dominoe effect throughout the market.

- The London market seems to be holding up better than other areas and demand is there but it is the lack of affordable or available lending that is causing the greatest difficulty.

- There is an over supply of commercial office, retail and warehouse space in and around all our main cities; rental uptake is very low.

- Construction contacts typically have a life of nine months or more. If the financial situation remains as it is then it is likely that there will be a further fall off in work as current contracts complete over the next year. This will cause companies to close. Many companies are family or privately owned and can hold on a little better since there is no shareholder pressure – but there are clear limits to the ability to do this. The projected period of difficulty is seen as 2 to 3 years.

- Redundancies are a regular occurrence and there are no other jobs for these people to go to. Many of those being made redundant are likely to remain unemployed for the foreseeable future. With an industry with a high level

of subcontractors and self-employed specialists many of the redundancies will be hidden and while not always appearing on the statistics will certainly affect the local economy. The real fear is that capacity and expertise will be lost which will not be easy to build up again in the future. Already many companies are abandoning their apprentice programmes and apprentices have already been made redundant in many companies[2]. Companies need to cut their outgoings and reserve their financial strength for recovery, however, cutting too hard can destroy cash-flow, the life-blood of any company but particularly crucial in construction where there is a high level of cash-flow due to the nature of development projects.

- Planning restrictions are causing problems resulting in delays and additional costs. Further re-organisation is likely to increase the level of delay. The delays are not just occurring at a planning office level but also at a strategic level with a number of promised public sector projects very slow to materialise. There are also anecdotally reported cultural differences between the local authority's and the developer's approach to contracts, especially those with a social housing element – with a reported underlying distrust of the profit motive, which inhibits partnership working.

13. We must not overlook the fact the construction industry is very significant: its output is worth over £100bn a year. It accounts for 8% of GDP and provided until last year employment for around 3 million workers.

14. On 5 June 2009, the Office for National Statistics (ONS) reported the biggest fall in construction output since Britain was engulfed by the "big freeze" of 1963. This has now led to an even bigger slump in the economy during the first quarter of this year than the 1.9% drop originally estimated.

15. City analysts said a 9% fall in a sector that straddles house building, commercial property and repairs to existing buildings would shave a further 0.3 points off GDP in the first three months of the year. A 2.2% drop in GDP would be the weakest since the 2.4% contraction in the autumn of 1979.

16. In its early estimate of first-quarter GDP, the ONS had pencilled in a decline of 2.4% in construction output during the winter, but it said recently that the severity of the recession was greater than in any of the three major postwar downturns in the 1970s, 1980s and 1990s.

17. The data shows the UK economy shrinking and construction 2.4% down, the biggest fall in 30 years as the industry's recession gathered pace over the winter months. So money is getting tighter.

18. The ONS said very recently that the wider measure of industrial output, which includes energy production, fell by 2.5% on the month. Analysts had forecast an increase of 0.2%. Manufacturing output fell by 1.9% in August, compared with a revised increase of 0.7% in July. The last time it was at such a low level was in 1992. Economists hoping for a resumption of growth in the third quarter warned that the figures could damage Britain's recovery prospects.

2 Even in the law amongst solicitors many trainee solicitors are finding their training contracts have been 'postponed', though public sympathy and the violins may not come out so quickly.

19. A return to GDP growth in the third quarter "now looks less certain," said Vicky Redwood, UK economist at consultants Capital Economics. She added: "August's dismal industrial production figures will dampen some of the recent optimism about the economy's apparent bounce-back."

20. I always recall my father saying to me as a boy that an army marches on its stomach. Contractors and subcontractors in the construction industry run on cash. Cash is king.

21. As "The Money Programme" from Monty Python's Flying Circus amusingly sang, "... There is nothing quite as wonderful as money; there is nothing quite as beautiful as cash."

22. When you really begin to think about business, the bottom line is all about making a profit, it is why businessmen get out of bed. However for contractors where margins are so very low even in the 'good times' breaking even ain't bad.

23. However, to achieve that, much has to happen and it is here that many business owners come up short. One vital ingredient they so often lose sight of is their cash flow and preserving its supply by making sure it does not take on too many commitments and that the work it does carry out is paid for. Obviously, the prevalence of disputes in the industry is not great for being paid promptly and the UK construction industry traditionally suffered from a reputation of being inefficient and adversarial, particularly with regard to the relationship between main contractors and their domestic subcontractors and that did not help cash flow one iota.

24. The "cash is life blood" argument reached its zenith just when I was leaving my primary school in 1971 when the Court of Appeal in *Dawnays Limited v. F. G. Minter Limited and Trollope and Colls Limited*[3], held that when a sum is certified by an architect as due under a building contract (in that case the RIBA form) the employer has no right of set-off. The justification for this decision was said to be that cash flow is the life blood of the building trade. The Court of Appeal attempted to treat interim certificates as the equivalent of cash and held that under the standard form of building contract they were not capable of challenge by the employer. The position was then reversed in 1973, the year when those old enough will remember we were being pressed to "Plant a tree in 73", in *Modern Engineering (Bristol) Limited v. Gilbert-Ash (Northern) Limited*[4], per Lord Denning which 'clarified' that a main contractor was entitled to set-off its claims for defects and delays against sums certified as due to a subcontractor. The decision came as something of a shock in the Official Referees' corridor. When the *Modern Engineering* case reached the House, we heard, 'It is not to be supposed' Lord Diplock said, at 718:

> that so elementary an economic proposition as the need for cash flow in business enterprises escaped the attention of judges throughout the 130 years which had lapsed between Mondel v. Steel (1841) 8 M. & W. 858 and Dawnays' case in 1971...

25. And so the House held, restoring the decision of His Honour Judge Edgar Fay Q.C., that the ordinary common law right of set-off, whereby a breach of warranty may be set up in diminution of the price, applies as much to building contracts as to

3 [1971] 1 W.L.R. 1205
4 (1973) 71 L.G.R. 162

contracts for the sale of goods.

26. However, whilst there is nothing particularly special about construction contracts compared with others in commerce (perhaps save their duration, we only have to look at the British Library, Heathrow's Terminal 5, the Channel Tunnel and now Cross Rail to see why), the fact that the ordinary rules of the law of contract apply is subject to an important qualification. Left to free market forces, the "life blood of the industry" was simply not making its way down the chain to the sub-contractors and it was largely for that reason that the "light touch" of adjudication was introduced.

27. The legislation passed following the recommendations of the Latham Report (*Constructing the Team*, 1996) treated construction contracts as a special category requiring statutory intervention. The introduction of Housing Grants Construction and Regeneration Act 1996, Part II (HGCRA) has also fundamentally altered the allocation of risks in construction contracts[5]. Adjudication has largely addressed the 'need for speed' in providing a process[6], which results in enforceable decisions. All parties before entering into contracts have to consider how they will deal with the legislation. It also provides a much wider definition of what, for the purposes of the legislation, is a construction contract as that term is widely defined[7].

28. Since modern adjudication, our industry has overcome many of the injustices of money not flowing down the pipe, but a problem remains as those with purse strings tighten their belts through austerity and self-preservation. We are today looking at adjudication in a different setting, more blood potentially on the carpet as parties get to grips with the screws turning.

5 I remember well during the very late 1980s the economic slump making impact upon the construction industry in the UK causing a massive shift from large, directly employed workforces towards a system of project managing sub-contractors. At the same time in a rare display of industry consensus, there appears also to have been the distinct feeling that some deeper malaise lurked within the UK construction industry. By then RSC Order 14 and Order 29 were becoming in effective summary tools in the solicitors' armory to recover monies. The first to pick up on this was the ICE, whose Legal Affairs Committee instructed a "Fundamental review of alternative contract strategies with a view to identifying the needs of good practice". That was swiftly followed, however, by the UK construction industry and the Conservative government of the day combining jointly to instruct Michael Latham (as he was then) to carry out an industry review. The wide-ranging Latham Report with its carefully constructed set of interlocking recommendations has, sadly, largely met the fate of such reports, which preceded it. Under pressure from lobbying groups for sub-contractors, however, the incoming Labour government of the day was persuaded to adopt the Latham recommendations on payment and adjudication at least, and civil servants were instructed to introduce appropriate provisions into a passing Bill dealing with housing grants, regeneration, architects and the like. The result, as we all know, became the Housing Grants, Construction and Regeneration Act 1996 and it was introduced into the House of Lords by Lord Ackner (as Rudi Klein has reminded us countless times) as follows:

> *"Adjudication is a highly satisfactory process. It comes under the rubric of 'pay now, argue later' which is a sensible way of dealing expeditiously and relatively inexpensively with disputes which might hold up completion of important contracts."*

6 But not the adjudication in the old order that my firm tested 19 years ago in *A. Cameron v John Mowlem & Co (*1990) 52 B.L.R. 24, CA.

7 Section 104(1) of the HGCRA states that a 'construction contract' includes:
- the carrying out of construction operations
- arranging for the carrying out of construction operations by others, whether under a subcontract to him or otherwise
- providing his own labour, or the labour of others, for carrying out construction operations

(2) Adjudication – a right to treat at any time

29. In some ways, dispute resolution in the UK has never been more exhilarating in terms of the options, speed and costs. The advent of adjudication has totally transformed the scenery. It has had a profound effect on all other forms of dealing with construction disputes.

30. The 'new' procedures[8] of which adjudication is but one are, generally, not finally determinative in the way that litigation or arbitration or expert determination is. The new procedures are, in effect, preliminary processes which the parties can use, if they so choose, in order to avoid a subsequent final determination by a court, arbitrator or expert. Further, these new procedures have been welcomed and adopted widely, both in the UK and abroad, because they offer to parties the possibility of controlling and reducing the particular hazards associated with the final determination procedures, namely:

    (i) cost;
    (ii) time; and
    (iii) uncertainty of outcome.

31. In addition the right at "any time" (without the 'need' for lawyers for those that cannot afford to or choose not to) to adjudicate is of course a superior right in many ways and is aided by the court's attitude to supporting adjudication at the enforcement stage which has if anything hardened views that adjudication decisions stick on the whole if and until 'rolled' by a superior tribunal. This robust view is perhaps not surprising as when parties challenge adjudicators' decisions, they after all are doing so because they are dissatisfied with the outcome. This is in contradiction to the principle of "pay now and argue later". The courts have closed various doors to challenging adjudication decisions over the last 10 years. In *Bouygues* this happened in relation to errors and the attitude of the court in relation to potential insolvency. *Carillion*[9] and *Kier*[10] are examples of another such door closing which affects every type of challenge, not just those relating to natural justice.

32. As Mr. Justice Jackson (as he then was) gave clear judicial guidance after considering the relevant cases on inter alia natural justice when he ruled on challenges to adjudication in *Carillion* he restated four basic principles as follows:

    1. The adjudication procedure does not involve the final determination of anybody's rights (unless all the parties so wish).

    2. The Court of Appeal has repeatedly emphasised that adjudicators' decisions must be enforced, even if they result from errors of procedure, fact or law: see *Bouygues, C&B Scene* and *Levolux*.

    3. Where an adjudicator has acted in excess of his jurisdiction or in serious breach of the rules of natural justice, the court will not enforce his decision: see *Discain, Balfour Beatty* and *Pegram Shopfitters*.

    4. Judges must be astute to examine technical defences with a degree of scepticism.

8 Preliminary Determination Procedures
(iv) Mediation;
v) Early Neutral Valuation (ENE);
(vi) Adjudication; and
(vii) Dispute Boards/Panels.
The use of protocols, and
Final Determination Procedures:
(i) Court litigation;
(ii) Arbitration;
(iii) Expert Determination.

9 Carillion Construction Limited v Devonport Royal Dockyard [2005] BLR 310 TCC

10 Kier Regional Limited (t/a Wallis) v City & General (Holborn) Limited [2006] EWHC 848 (TCC)

33. Consonant with the policy of the HGCRA, errors of law, fact or procedure by an adjudicator must be examined critically before the Court accepts that such errors constitute excess of jurisdiction or serious breaches of the rules of natural justice: see *Pegram Shopfitters* and *Amec*. What we have seen in the last 2 years in particular is this policy of light purposive touch in action in the TCC.

34. So rather than the old order of having to litigate or, as was usually the case, await completion of the works so as to be able to arbitrate or, in desperation, walking off the job, our current custom is to seek a temporarily binding decision in adjudication which is often as far as a dispute will go in terms of formal process. Not bad for a right the legislature has given the industry.

35. Adjudication started really to fly from February 1999 in *Macob Civil Engineering Limited v Morrison Construction Limited* where Mr Justice Dyson said the following:

> 14. The intention of Parliament in enacting the Act was plain. It was to introduce a speedy mechanism for settling disputes in construction contracts on a provisional interim basis, and requiring the decisions of adjudicators to be enforced pending the final determination of disputes by arbitration, litigation or agreement… The timetable for adjudication is very tight…Many would say unreasonably tight, and likely to result in injustice. Parliament must be taken to have been aware of this…But Parliament has not abolished arbitration and litigation of construction disputes. It has merely introduced an intervening provisional stage in the dispute resolution process. Crucially, it has made it clear that decisions of adjudicators are binding and are to be complied with until the dispute is finally resolved.

36. Adjudication has not looked back since; yes, it has kept the courts busy on summary enforcement but far fewer cases now go to trial than used to be the case as domestically the fight takes place at the front end. No more so than when the money gets tight!

37. However, the Scots may be eroding this principle. In *Phoenix Contracts (Leicester) Limited v Central Building Contractors (Glasgow) Limited t/a CBC Stone* (Glasgow Sheriff Court, 24 June 2009, unreported). Phoenix argued that CBC had lost its right to adjudicate because it had waited too long before starting an adjudication. (CBC had started a claim in the Glasgow Sheriff Court in October 2008 and, by the time it issued a Referral Notice in June 2009 (referring the same dispute to adjudication), the parties were less than 2 months from trial.)

38. Phoenix asked the court to grant the Scottish equivalent of an injunction to stay the adjudication, arguing that CBC had waived its right to adjudicate because it had started court proceedings and then referred the same dispute to adjudication late in the day.

39. Despite the statutory nature of the right to refer a dispute to adjudication "at any time", it appears the Sheriff thought there could be exceptions to this right - a party could waive its right to adjudicate - and the Sheriff granted the injunction. In reaching this conclusion, the Sheriff reviewed CBC's actions and found 3 factors that were particularly relevant:

- The court proceedings were well advanced when the matter was referred to adjudication.

- The value of the claim was low (about £40,000).

- CBC was unlikely to enforce the adjudicator's decision before judgment was issued in the court action.

(3) Section 11 of the Insolvency Act 1986 – administration - a trap for the unwary

40. We are in challenging times. Adjudication is not all plain sailing, and the effect of insolvency on adjudication is a real concern now that so many businesses are failing. The legal landscape has changed. For a start, since the recession of the early nineties there have been a number of important changes to insolvency law, but the way in which insolvency law[11] interacts with the statutory right to adjudication is, in many respects, still opaque.

41. It is to be noted that following the Enterprise Act 2002, section 11 of the Insolvency Act 1986 has been replaced by the new administration procedure in Schedule B1 of Insolvency Act 1986. The corresponding provision is contained in paragraph 43(6) of Schedule B1, which states that: *"no legal process (including legal proceedings, execution, distress and diligence) may be instituted against the company or property of the company except (a) with the consent of the administrator, or (b) with the consent of the Court".*

42. One of the few circumstances in which the courts may not enforce an adjudicator's decision is where there is actual or potential insolvency of the party due to receive payment.

43. 'My' case of *Herschel Engineering Ltd v Breen Properties Ltd*[12] was one of the first 9 years ago if not the first where HHJ Lloyd QC considered the unusual nature of the adjudication award in the context of other process that might be concurrent with it:

> The debt which crystallises as a judgment debt is, however, one of a somewhat unusual nature, since it stems from the decision of an adjudicator which is provisional and not final and is capable of being reversed in that the ultimate tribunal (court or arbitrator) which has jurisdiction to resolve the dispute finally may take a different view.
>
> The adjudicator's decision is not therefore a decision for all time that the defendant owes the claimant a particular sum of money. It is merely a decision that, at the present time and on the basis of the material then available to the adjudicator, a sum of money appears to the adjudicator to be due ...

44. The court considered how the rights of the parties could be balanced:

> The court has to be satisfied that enforcement of the decision would result in such injustice to the defendant that it would not be a just way of dealing with the case consistent with the overriding objective...
>
> A court would clearly need to take account of all the circumstances, such as the time that had elapsed since the events giving rise to the dispute had occurred and the conduct of the parties thereafter ...
>
> ...There are other factors, some of which are mentioned in Order 47, such as the possibility that the applicant might <u>not</u> be able to pay the money ...

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11 A new administration procedure commenced on 15 September 2003 with the Enterprise Act 2002. It abolished the Crown's preferential right to recover unpaid taxes ahead of other creditors - this will bring real benefits to unsecured creditors, including many small firms.

The Act streamlined the system of administration, removing the need for a court hearing in most cases, whilst retaining its collective nature and providing adequate safeguards for all stakeholders. Administration is now more accessible, cheaper and less bureaucratic. The Act restricts the use of administrative receivership (why we see so few indeed, if the debenture was created after 15.9.2003 the debenture-holder cannot appoint an administrative receiver) and shifts the balance in favour of administration, which is a collective procedure and takes account of the interests of all creditors.

12 [2000] BLR 272

45. RSC Order 47, preserved as Section A of the Civil Procedure Rules 1998 states:

> 1 (1) Where a judgment is given or an order made for the payment by any person of money, and the court is satisfied, on an application made at the time of the judgment or order, or at any time thereafter, by the judgment debtor or other party liable to execution:
>
> (a) that there are special circumstances which render it inexpedient to enforce the judgment or order; or ...
>
> …the court may by order stay the execution of the judgment or order…either absolutely or for such period and subject to such conditions as the court thinks fit.

46. *Herschel* revealed there was then no consensus among the authorities about the time at which it is appropriate to judge the claimant's inability to repay the relevant amount; the decision of HH Judge LLoyd QC suggests that this should be judged as at the time repayment is likely to become due. Judge LLoyd did indicate that an application for a stay on the basis that the successful party in the adjudication would not be able to repay the money once the dispute had been finally resolved, provided that it was supported by solid information in support, would be treated with some sympathy by the Court. Judge LLoyd also commented on the complete failure by Breen to have taken any further steps to pursue the County Court action (since the first hearing at the TCC), which was an inactivity which clearly "did not square with the underlying intention of their application.

47. In *Bouygues (UK) Ltd v Dahl-Jensen (UK) Ltd* (2001), the Court of Appeal held that where the receiving party was in liquidation, it would be wrong for the sums awarded by the adjudicator to be paid, as this would lead to injustice between the parties:

> In circumstances such as the present, where there are latent claims and cross-claims between parties, one of which is in liquidation, it seems to me that there is a compelling reason to refuse summary judgment on a claim arising out of adjudication which is necessarily provisional. All claims and cross-claims should be resolved in the liquidation in which full account can be taken and a balance struck. That is what r 4.90 of the Insolvency Rules 1986 requires.

48. In *Hart v Fidler and Another* (2006) a similar decision was reached.

49. The case law is more difficult where the party seeking enforcement is in financial difficulties. Is it fair to pay over the money due now only to find when the dispute is finally determined that the receiving party can no longer pay it back?

50. In *Rainford House (in Receivership) v Cadogan* (2001) a stay was granted when there was a strong case on the face of it that the claimant was currently insolvent and that evidence had not been corrected or explained.

51. In *Ashley House plc v Galliers Southern Ltd* (2002) where the claimant was in a "parlous financial condition", albeit falling short of insolvency, the judge ordered a payment into court. He was swayed in part by a recent notice of referral to arbitration.

52. In *Tera Construction Ltd v Yung Ton Lam* (2005)[13] it was held that although it was not clear what the present financial position of the claimant was, it had not been shown to be insolvent and there was no evidence that it was in any worse financial state than when the parties entered into the contract for the works in question.

53. However, whilst one of the cornerstones of the adjudication procedure is that a construction contract enables a party to give notice "at any time" of its intention to refer a dispute to adjudication, there are one or two exceptions.

54. This feature of the HGCRA, however, does not sit comfortably with the case of *A Straume (UK) v Bradlor Developments*, where the contractor (Bradlor) went into administration and its administrators commenced adjudication against the employer (Straume) for sums due. The employer served its own adjudication notice; this raised counterclaims that exceeded the contractor's claims.

55. An issue arose as to whether the employer's adjudication could proceed in the light of the Insolvency Act, which says: "During the period for which an administration order is in force, no other proceedings may be commenced except with the consent of the administrator or court." It is clear law that a proceeding for adjudication under s.108 of the HGCRA, is a proceeding within the meaning of s.11 (3)(d) of the Insolvency Act. This was followed in *Canary Riverside Development v Timtec International*[14].

56. The courts so far have found that the adjudication regime does indeed fall within the scope of "other proceedings". Thus, Straume's adjudication could not proceed without the court's permission. Having decided this, the court refused to grant permission. It seems a party in administration can kick but not be kicked.

57. One can see where this might lead to with insolvency, and I am seeing in more and more cases where this will be further complicated by the fact that legal proceedings (including adjudication) cannot be started against contractors in administration or liquidation[15] without the consent of the administrator or liquidator or the leave of the court. Another difficulty if one has a security document like a bond and it is a condition of the bond that a judgment or award be obtained as proof of the employer's loss, then, arguably, the bond confers no protection on the employer in the event of an administration or liquidation of its contractor.

58. As long as *Straume and Timtec* remain the only main authorities on the point, it appears that where a putative responding party is in administration, a claimant cannot simply commence adjudication "at any time". In a credit crunch this goes down like a lead balloon. Where a respondent to adjudication is in compulsory liquidation, the Insolvency Act 1986, s11 says: "No action or proceeding shall be proceeded except by leave of the court." The *Straume* decision would apply equally to an opposing party in compulsory liquidation, although this has yet to be tested.

Voluntary liquidation

59. In the case of a voluntary liquidation, there is no statutory requirement to obtain permission, but the liquidator can apply for a stay of adjudication proceedings if it

13 [2005] EWHC B1 (TCC)

14 The trade contractor went into administration. The employer sent a cheque in respect of payment applications to the trade contractor after it went into administration. After the cheque was presented, the employer was informed of the administration and stopped the cheque.
The employer determined the trade contractor's employment under the trade contract. It also issued notices of withholding under section 111 of the Housing Grants, Construction and Regeneration Act 1996 in respect of any sums otherwise due under the contract on the basis that it was not liable under the trade contract to make any further payment to the trade contractor until the development's practical completion.
The employer applied for leave pursuant to section 11(3)(d) of the Insolvency Act 1986 to start adjudication proceedings. However, the trade contractor had already started court proceedings for payment of the amount of the cheque. The registrar at first instance refused to grant leave to the employer. The employer appealed.
David Oliver QC on appeal held that the employer should not be granted leave to start adjudication proceedings against the trade contractor. The deputy judge stated that it was clear law that adjudication proceedings were "proceedings" within the meaning of section 11(3)(d).
In addition, an appeal against a refusal to grant leave under section 11 application should only be granted where the court was satisfied that the judge at first instance had exercised his discretion on wrong principles. Despite it being accepted on appeal that the employer had not served it withholding notices out of time, a large part of the justification for such an adjudication process disappeared where, as in the instant case, court proceedings were already underway. The claims being made by the employer against the trade contractor were perfectly capable of being resolved in the court proceedings begun by the trade contractor with the result that it was difficult to say that the decision of the registrar at first instance was flawed. Thus, the court will be unlikely to grant leave for a proposed claimant to begin adjudication proceedings against a company during the period that an administration order is in force against it where the company has already begun court proceedings against the proposed claimant, which will resolve the outstanding issues between the parties.

15 The permission of the court is needed to bring a claim in adjudication against a company in liquidation. Clearly, in any event this would be an unlikely course for a party to take, on commercial grounds.

is in the creditors' best interest.

Receivership

60. There is no need to seek the court's permission to adjudicate against a company in receivership, and no special rules apply in cases in which a company in receivership wishes to bring a claim in adjudication. However, in the event that an adjudicator's decision is enforced by a court giving judgment in favour of a company in receivership, a stay of execution may be granted. Where a company enters into a compulsory voluntary arrangement (CVA), while there is no need to seek the permission of the court to proceed with adjudication, the terms of the arrangement will provide for a stay. The scope of that stay is a matter for the creditors and the company to agree.

61. Although the decisions in *Straume and Timtec* may well be sensible from an insolvency point of view, they are contrary to what common sense would suggest from a construction disputes perspective given obtaining a declaration of entitlement is particularly important when the going gets tough, and given that the tide has, for a decade, been running in adjudication's favour and against litigation.

62. If a counterparty is insolvent in the PFI world, the adjudication mechanism in an adjudication bond, which is a stand-alone adjudication procedure, can be used to obtain a quick decision as to the contractor's liability without the need to adjudicate against it but I have seen them only on PFI contacts.

63. In the current climate, in which a party's ability to adjudicate pursuant to the HGCRA may well be constrained by insolvency legislation there will be injustices where the shutter comes down but I see no easy solutions. When the music stops someone will always wobble.

(4) Stays to enforcement and blocking moves where the enforcing party is insolvent

64. If a contractor gets a decision in his favour and heads for enforcement and monies paid could be lost for all time if paid in the 'wrong' direction it pays to put some anchors on the process by getting a stay of execution. If the contractor is in actual liquidation then this is usually straightforward and easy, but if not you may still get a stay of execution if you can show credible evidence the contractor will not be in business long enough to right a wrong adjudicator's decision through the courts or arbitration.

65. However, the mere fact of doubts over the claimant's financial ability to repay the amount of the decision should not disentitle the claimant from enforcing that decision.

66. In *Wimbledon v Vago*[16], Judge Coulson (as he then was) set out the principles applied by the court in exercising its discretion:

a) Adjudication (whether pursuant to the 1996 Act or the consequential amendments to the standard forms of building and engineering contracts) is designed to be a quick and inexpensive method of arriving at a temporary result in a construction dispute.

b) In consequence, adjudicators' decisions are intended to be enforced summarily and the claimant (being the successful party in the adjudication) should not generally be kept out of its money.

c) In an application to stay the execution of summary judgment arising out of an adjudicator's decision, the Court must exercise its discretion under Ord.47 with considerations a) and b) firmly in mind.

d) The probable inability of the claimant to repay the judgment sum (awarded by the adjudicator and enforced by way of summary judgment) at the end of the substantive trial, or arbitration hearing, may constitute special circumstances within the meaning of Ord.47 r.1(1)(a) rendering it appropriate to grant a stay.

e) If the claimant is in insolvent liquidation, or there is no dispute on the evidence that the claimant is insolvent, then a stay of execution will usually be granted.

f) Even if the evidence of the claimant's present financial position suggested that it is probable that it would be unable to repay the judgment sum when it fell due, that would not usually justify the grant of a stay if:

(i) the claimant's financial position is the same or similar to its financial position at the time that the relevant contract was made; or

(ii) The claimant's financial position is due, either wholly, or in significant part, to the defendant's failure to pay those sums which were awarded

16 [2005] 101 Con LR 99 TCC

by the adjudicator.

67. In considering whether to grant a discretionary stay however the applicant defending party must make the running of proving insolvency, a probable inability to repay the judgment sum if that was the outcome of the final dispute process in twelve months time is not enough.

68. It is necessary for the court to give sufficient weight to the right of the claimant to have his decision enforced and the court is unlikely to grant a stay on limited or flimsy evidence of impecuniosity. The test to be applied under s.726 (1) of the Companies Act 1985 in relation to security for costs is a helpful analogy. A stay may not be justified if the claimant's financial position is the same or similar to the position when the contract was made or if the claimant's financial position is due in whole or in significant part to the defendant's failure to pay sums awarded by the adjudicator.

69. When the court is invited to exercise that jurisdiction under s.726 the evidence which is adduced is usually as to the financial position of the claimant company as at the date of the hearing of the application. The court is then invited to infer, and usually does, unless evidence is put before it on behalf of the company which shows a different picture, that the then position of the company will continue. In the same way, it is appropriate when considering an application for a stay of execution over an enforcement, to proceed on the basis that once the applicant for a stay has adduced apparently credible evidence which, if uncontradicted, shows that the claimant in the action is then insolvent, it is for the claimant, if it wishes the court not to draw the inference for which the applicant for the stay contends, to seek to contradict the evidence adduced on behalf of the applicant. In the absence of evidence to suggest that the position as it appears at the time the application is before the court is likely to alter the inference which should be drawn is that it will not.

70. For those instances where the enforcing party goes into liquidation <u>after</u> the decision in its favour *Bouygues (UK) Ltd v Dahl-Jensen (UK) Ltd* as I have already said is the leading case. It held that summary judgment should be refused in relation to sums awarded in favour of the sub-contractor by an adjudicator on the basis that the accounting between the sub-contractor and contractor should be undertaken pursuant to r.4.90[17] of the Insolvency Rules 1986. Obviously, you have to demonstrate that the contractor is insolvent.

71. Therefore, it is for the applicant for any stay of enforcement to put before the court credible material, which, unless contradicted, demonstrates that the claimant is insolvent. However, it is not necessary for the applicant for the stay to go further than to put before the court evidence as to the present financial position of the claimant, so that he does not need to shoulder some additional burden of predicting when any challenge to the correctness in fact of the determination of the adjudicator will be heard (like at a later trial) of putting before the court positive evidence as to what the financial position of the claimant will then be.

72. The burden which the applicant for a stay bears is not that of demonstrating beyond the possibility of error that the claimant will, come the time when the correctness

[17] A company in liquidation may bring a claim in adjudication. Where the responding party has a set-off or claim of its own, however, the adjudicator's decision will be of little effect, as the parties' claims and cross-claims will be set off against one another in accordance with Rule 4.90 of the Insolvency Rules. The court will not usually enforce an adjudicator's decision in these circumstances. Note that where a company in liquidation brings a claim in adjudication and the responding party does <u>not</u> have a set-off or claim of its own, the company in liquidation is entitled to enforce the adjudicator's decision in its favour. This was the case in the *Fastrack Contractors Ltd v Morrison Construction Ltd* case, where the claimant seeking to enforce an adjudicator's decision had gone into liquidation by the time of the enforcement hearing.

or otherwise of the decision of the adjudicator is determined, be unable to repay the amount determined by the adjudicator to be payable.

73. The recent *Mayor and Burgesses of the London Borough of Camden v Makers UK Limited*[18] decision in the TCC sheds light on the approach that the Court will take in relation to referral to adjudication where the referring party is insolvent.

The Facts

74. Camden, the claimant local authority, employed the defendant contractor, Makers, to carry out certain work. Camden later sought to determine Makers' employment for being tardy with its works. Makers subsequently referred a dispute to adjudication about whether its employment was lawfully determined. The adjudicator found in Makers' favour.

75. Camden feared that, on the back of this adjudication, Makers would commence a further adjudication and seek significant sums for wrongful termination. On the classic accountancy test Makers was insolvent and Camden was concerned that any payments made to Makers pursuant to an adjudicator's decision would disappear to Makers' creditors. Not an uncommon concern in my experience in such cases in these times.

76. Camden therefore issued Court proceedings against Makers, seeking to forestall a further referral to adjudication by establishing that Camden had in fact acted correctly in determining Makers' employment, and claiming around £1m for the costs flowing from the contract's determination. Makers did not file its defence in time, and Camden successfully applied for judgment in default against Makers.

Application to Set Aside Default Judgment

77. Makers applied for the default judgment to be set aside. Of particular attention was Camden's submission that the court should only exercise its discretion to set aside the default judgment upon condition that Makers would not initiate any further adjudications against Camden. In refusing to impose such a condition, Akenhead J made the following remarks:

- Makers' failure to serve a Defence within the permitted time was an oversight. Camden should not be allowed to exploit this fortuitous event to get around the established principle that an adjudication can be pursued concurrently with court proceedings;

- The court will only inflict conditions on a party seeking to adjudicate in the most exceptional of circumstances. The fact that the referring party is insolvent is not an exceptional circumstance;

- If an insolvent referring party plans to adjudicate it must weigh up the potential advantages of doing so against the risk that a court could stay a judgment to enforce an adjudication decision on the grounds of insolvency and inability to repay. Even if an insolvent referring party were to be successful in an adjudication, the responding party would in any event be

[18] [2009] All ER (D) 301 (Mar)

able to get a stay of execution on any enforcement judgment relating to that adjudication unless:

(i) the insolvent claimant's financial position was similar to its position at the time the relevant contract was made; or

(ii) the insolvency was due in significant part to the defendant's refusal to pay the sums awarded by the adjudicator.

Implications

78. The court's accent on the pre-eminence of the right to refer a dispute to adjudication "at any time" is nothing new, but this is a remarkable example of just how far the Court will take this and is all the more worth mentioning in the current economic crisis.

79. Given that a stay of execution will ordinarily be granted it may be tempting simply to pay no attention to an adjudication initiated by an insolvent referring party, as in any event the referring party will not be able to enforce a judgment obtained from an adjudication (subject to the exceptions set out above).

80. This policy I now observe is ill advised. A party appearing at first sight to be in mortal shape may subsequently be revitalized, leaving the responding party to face an uncontested adjudicator's decision, without recourse to enforcement arguments based on the insolvency. An insolvent party to an adjudication will often be a rival that needs to be guarded against, irrespective of the fact that in the majority of cases a victory by the insolvent party will ultimately prove to be a hollow one.

Third-party backers?

81. This decision also throws up the absorbing possibility that an "investor" or claims consultant could bankroll the adjudication of an insolvent referring party in return for a share of the proceeds of a successful adjudication. Such an arrangement may not fall foul of the existing restrictions on champerty[19] and third party funding litigation[20] (as adjudication is a different beast to litigation)!

82. One can envisage circumstances where it would be tricky for the unsuccessful responding party to apply for a stay of enforcement of the judgment, particularly if the party bankrolling the referral was a well heeled company which had taken assignment of the rights (but not the obligations) of the insolvent referrer. As the economic climate deteriorates, it is to be expected that the legality of such a scenario will be played out in the courts.

19 Champerty 'occurs when the person maintaining another stipulates for a share of the proceeds of the action or suit' Chitty 28 Ed Vol 1 17 – 054.

20 The law in relation to maintenance depends upon public policy and so must be continually kept under review – see *Hill v Archbold* [1968] 1 QB 686 at 697. The introduction of CFAs is an example of public policy changing. In the case of *Factortame* the CA held that:

> Where the law expressly restricts the circumstances in which agreements in support of litigation are lawful, this provides a powerful indication of the limits of public policy in analogous situations. Where this is not the case, then we believe one must today look at the facts of the particular case and consider whether those facts suggest that the agreement in question might tempt the allegedly champertous maintainer for his personal gain, to inflame the damages, to suppress the evidence, to suborn witnesses or otherwise undermine the ends of justice. (paragraph 36)..."

Third Party Funding is similar to ATE Insurance in that a Third Party Funder will bear the legal cost risk of a client's litigation in the event that the case is unsuccessful. However, unlike ATE insurance, the Third Party Funder also provides interim financing for the client's own legal costs in order to progress the case (ATE Insurers generally only pay costs if the case is lost). But a growing number of investors are willing to bankroll the cost of litigation, in return for a guaranteed share of the compensation. They may even offer to underwrite the opponent's costs if the claimant loses or buys an insurance policy that does so. Hedge funds, private equity firms and high net worth individuals are some of the players now being attracted by the potentially high returns litigation funding offers them. Some think this appetite will only increase while the outlook for traditional investment markets remains dire.

(5) CVAs and enforcement

83. A knotty issue has been whether the losing party in an adjudication can resist enforcement of an adjudicator's decision in the event that the successful party becomes the subject of a Company Voluntary Arrangement ("CVA"). This point came up for the first time only a few weeks ago. The case is *Mead General Building Ltd v Dartmoor Properties Ltd.*[21]

84. The implication of this case goes to whether entering into a CVA will or will not automatically prevent enforcement. The answer seems to be that before granting a stay, the courts will look at all the circumstances, including the CVA itself, to determine if the successful party will eventually be able to repay the judgment sum.

85. As we have seen it is trite law that the courts will enforce an adjudicator's decision whether right or wrong unless the adjudicator did not have the jurisdiction to reach his decision or there had been a material breach of the rules of natural justice.

86. In exercising its discretion to stay the execution of summary judgment at enforcement proceedings, following the issue of an adjudicator's decision, the court will also consider the financial standing of the successful party in the adjudication. If there is a probability that the successful party will be unable to repay the judgment sum (awarded in any enforcement proceedings) once the matter in dispute has been finally dealt with in arbitration or litigation, then the courts may consider it appropriate to grant a stay.

87. In the case of *Rainford House Limited v Cadogan Limited* [2001], the TCC granted a stay of execution on the basis that Rainford was in administrative receivership and was thought unable to repay at a later date the sum awarded. However, from other decided cases, it is clear that the courts will not grant a stay if either the successful party's financial position is the same or similar to that at the time of contract formation, or the successful party's financial position is due, in whole or in part, to the failure of the losing party to pay the sums ultimately awarded in the adjudicator's decision.

88. Until recently, there has been no authority dealing with the position of the successful party being the subject of a CVA. A CVA is a mechanism that provides a company with protection from creditors for a fixed period in order that debts can be paid out of future trading profits like Chapter 11 in the US. In Mead, Mr Justice Coulson had to consider an application by Dartmoor for a stay following *Mead* becoming the subject of a CVA.

89. In reviewing the various authorities to date, the judge said that the following principles emerge:

- In considering whether or not to grant a stay, the court will take into consideration the fact that Mead had become the subject of a CVA.

- The mere fact that Mead had become the subject of a CVA did not mean that it should be automatically inferred that it would be unable to repay any

21 [2009] EWHC 200 (TCC). The case is also noteworthy because This is an important judgment on natural justice and severability of adjudicators' decisions from Mr Justice Akenhead. This judgment confirms that the courts will have little truck with complaints that the responding party was 'ambushed', and extends in its obiter judgment the application of severability (first outlined by Akenhead J in *Cantillon v Urvasco*) beyond that originally envisaged.

sums paid as a consequence of summary judgment.

- The details and circumstances surrounding the CVA and Mead's current trading position will be relevant to the courts' consideration of any stay.

- Whether or not Mead's financial standing and/or the CVA was due in whole or in part to Dartmoor's failure to pay the sums awarded by the adjudicator.

Financial difficulties

90. As a matter of fact, Coulson J found that Mead's financial difficulties had their origins in its poor cash flow following Dartmoor's failure to pay the sums ultimately awarded in the adjudicator's decision. He noted that the sum of £350,000 awarded by the adjudicator represented a significant proportion of Mead's annual turnover. The judge accepted that very few businesses with Mead's annual turnover could continue to trade if owed as much as eventually found by the adjudicator.

91. As for the CVA, Coulson J noted that this was entered into following a winding-up petition by a creditor who was owed the relatively modest sum of £3,000. Although such a fact was indicative of serious financial difficulties on Mead's part, creditors were continuing to support Mead in trading and that the CVA was operating successfully.

92. Central to the judge's thinking was a statement from the CVA's supervisor, who was of the view that Mead could successfully trade its way out of their temporary difficulties. Coulson J found that, in that respect alone, the circumstances of this case could be distinguished from those in the *Rainford House* case, where the contractor was already in administrative receivership.

93. The judge concluded that Mead was a viable ongoing concern, notwithstanding being the subject of a CVA. Accordingly, he believed that Dartmoor had failed to make out the case for a stay.

94. While at face value this judgment could be welcomed by insolvency practitioners who previously may have been disheartened in using adjudication as a means of recovering monies owed, careful consideration of all of the circumstances of the insolvency will still be required before embarking on an adjudication that may ultimately have to be enforced.

95. It is helpful therefore that the Judge also held that, in considering an application for a stay, the court will also take into account the factor identified in *Wimbledon v Vago*, namely whether the financial difficulties that led to the CVA were caused solely or significantly by the defendant's failure to pay the sums awarded by the adjudicator as this is of course no a common occurrence in practice. Here Mead had very good evidence that the financial difficulties were caused by Dartmoor, not only from Mead's Managing Director but also, crucially, from Mead's accountant (who was independent). Again, this independent evidence was a factor which particularly militated in favour of refusing the stay.

96. This judgment confirms that, short of insolvent liquidation or administrative receivership, financial difficulties on the part of the claimant will not automatically entitle the defendant to a stay of execution. This decision is likely to be of considerable importance in the current economic climate where the enforcing party can convince the court it will remain a viable concern.

(6) Is adjudication quick enough or too fast for comfort?

97. By this, I mean is a 28 day process going to get the claiming party paid before the paying party is out of money or one of those insolvency processes locks its bank accounts? Alternatively, is it too quick in an ambush?

98. As Timothy Elliott QC wrote in *Building* recently, a feature of adjudication now unhappily familiar to practitioners is the way in which some referring parties apparently try to hinder the respondent's capability to respond to the claim. With short time limits in play, some will choose the most inopportune time to launch an adjudication and serve enormous quantities of documents - behaviour which sometimes resembles ambush by steamroller.

99. In *Dorchester Hotel Limited v Vivid Interiors Limited*[22] Mr Justice Coulson was faced with an adjudication in which he obviously felt this was happening. Vivid had been engaged by Dorchester to perform the refurbishment in its hotel. The final account was in dispute. The Friday before Christmas, Vivid started adjudication proceedings. The 92 page Referral Notice was accompanied by thirty seven lever arch files, six substantial witness statements and two experts' reports. Whereas it appears that much of this extensive material was not entirely new, at least five files were and many of the individual figures within the final account had been recast or amended.

100. The adjudicator was only prepared to accept the reference if Vivid agreed to ignore the holiday period from 24 December to 4 January 2009 for the purpose of the twenty eight days within which the adjudication had to be over and done with. Vivid agreed and in addition agreed a further extension to 28 February with a timetable which required Dorchester to respond to the claim by 28 January. However further than that Vivid was not prepared to go.

101. Dorchester said this programme was too tight and claimed there was a very real risk of there being a breach of natural justice. Using CPR 8 procedure the Dorchester sought declarations to that effect mid adjudication. Coulson J believed this raised the novel question of the extent to which the court should intervene in an ongoing adjudication in connection with potential breaches of the rules of natural justice.

102. The judge clearly commiserated with Dorchester. He said that Vivid had commenced the adjudication in the way it had in order to obtain the greatest possible advantage from the summary adjudication procedure. He added that it was a matter of regret that the adjudication process, which was itself introduced as a method of dispute resolution which would avoid unnecessary legal disputes and procedural shenanigans, was now regularly exploited in the same way. He also expressed confidence that the enthusiasts for adjudication in and out of Parliament in 1996 had not envisaged that the system would be used for making a claim of this type and in these circumstances. Whilst he accepted that Vivid was faced with an employer who was blanking it and that it had sought to ameliorate its conduct to some extent by agreeing a revised timetable, nevertheless his overall view was critical.

22 [2009] EWHC 70 (TCC)

103. Notwithstanding this, he did not grant Dorchester the declaration it sought. He rejected Vivid's argument that he did not have jurisdiction to grant the declarations, but he felt that he should not grant relief at this stage. To start with, he noted that the adjudicator himself had said that he could determine the dispute fairly within the time agreed to by Vivid. Secondly, although the timetable was tight, he could not say at this interlocutory stage that it was incapable of giving rise to a fair result. Additionally he was unable to reach a view as to whether there was so much new material that it would result in a breach of natural justice. Finally, if in the event there was a breach of natural justice, then Dorchester could resist enforcement of an adverse decision by the adjudicator on that ground.

104. It was perhaps a bit hopeful of Dorchester to ask for a finding of breach of natural justice in advance, as it were. However, the judge did ring some bells. He reminded the adjudicator that he had to continue to conduct the adjudication fairly, which might mean extending the timetable further. He also reserved costs which meant that if the decision was successfully challenged on natural justice grounds, Vivid might end up paying them. Therefore, in one sense Dorchester may have achieved its aim. This case underlines the position that only in the rarest of cases will the courts intervene in an ongoing adjudication. It is interesting to note that Mr Justice Coulson thought that the situation in *CJP Builders Ltd v William Verry Ltd* (2008) would have warranted such an intervention.

105. However, for some the statutory timetable in adjudication can be too long which is why we are seeing more enquiries about proceeding directly to a Petition in bona fide undisputed debt situations and companies are being squeezed to pay by the greatest fear they have of the bandwagon, the grapevine to which the banks are tuned in and the pip squeezing effect of an advertised Petition.

(7) The effect of determination on the enforcement of an adjudicator's decision

106. Let's look next at a common area in this credit crunch, that of determination[23] (sometimes automatic on an insolvency event, but not always) and whether the chop falling stops a money claim.

107. It was back in 2003, the Court of Appeal made an significant decision in the case of *Levolux AT Limited -v- Ferson Contractors Limited* Lord Justice Mantell said: *"The contract must be construed so as to give effect to the intention of Parliament rather than to defeat it. If that cannot be achieved, then the offending clause must be struck down."* In other words the contractual provisions could not be used to avoid compliance with the adjudicator's decision.

108. The situation in this case was that the claimant's JCT Minor Works Form, 1998 Edition had been determined by the defendant who then relied upon the determination provisions to avoid paying a sum decided as due to the claimant pursuant to an adjudication commenced after the determination.

109. *Westwood Structural Services Limited v Blyth Wood Park Management Company Limited* [2008][24] concerned an application to enforce an adjudicator's decision in the sum of £49,583.31 in circumstances where Blyth Wood Park were seeking to rely upon the determination of Westwood, employed under the JCT Minor Works 1998 Edition, to avoid complying with the adjudicator's decision.

110. The key facts in this case were that Westwood contended that the works were practically complete on 15 January 2008, relying on a letter from the Contract Administrator, but two days later there was a letter from the Contract Administrator expressing concerns about workmanship. Westwood was told by the Contract Administrator not to carry out any further work. On 16 April 2008 Westwood commenced an adjudication seeking declarations that practical completion of the works was achieved on 15 January 2008 and that the letter of 17 January 2008 was a repudiatory breach.

111. Westwood also claimed for sums due for the balance of the work at 15 January 2008. Then on 25 April 2008, the Contract Administrator determined the contract and it was argued in the adjudication that Blyth Wood Park now did not have to make any further payment because of the determination provisions of the contract.

112. Clause 7.2.3 of the contract states that "Upon determination of the employment of the Contractor the Employer shall not be bound to make any further payment to the Contractor that may be due under this Agreement until after completion of the works and the making good of any defects therein".

113. As to the arguments arising in connection with JCT clause 7.2.3, the Court held that it cannot operate as a defence to the claim. In the Court's opinion it would be contrary to the Standard Form of Contract, and indeed to the Housing Grants Construction and Regeneration Act 1996, to conclude that an Employer was entitled to defeat a claim for sums due under the contract by reference to an event which occurred after the monies should have been paid. Therefore, the Court concluded

23 The important House of Lords judgments in *Reinwood v L Brown & Sons* [2008] 1 W.L.R. 696, and *Meville Dundas Ltd (in Receivership) v George Wimpey Ltd*; [2007] 1 W.L.R. 1136 which related to the payment and determination provisions of JCT Standard Form of Building Contract 1998 and the 1996 Act are topics for a separate paper.

24 [2009] CILL 2666 TCC

that the Claimant was entitled to Summary Judgment in the sum of £48,583.31.

114. It is to be noted that in the adjudicator's first decision of 6 June 2008, he found that practical completion had occurred on 15 January 2008, that the letter of 17 January was not a repudiatory breach and he directed that the sum of around £40,000 plus VAT and fees should be paid to Westwood by Blyth Wood Park.

115. The adjudicator refused to deal with the question of the determination in his first decision because it arose after the adjudication had commenced. The adjudicator then decided in his second decision that Blyth Wood Park had validly determined the contract on 25 April 2008, but that clause 7.2.3 did not bite when the payment arose out of an adjudicator's decision and also that further payment in clause 7.2.3 applied to future payment not to payment that became due before the determination.

116. Despite these decisions, Blyth Wood Park refused to pay and Westwood applied to the court to enforce the adjudicator's first decision. You might expect that Blyth Wood was on a sticky wicket, but they nevertheless elected to defend the application on the basis that they argued that the sum directed to be paid by the adjudicator was not due until after the determination and it was not therefore due now.

117. In summary, Mr Justice Coulson enforced the adjudicator's decision for the following reasons:

- The adjudicator had in his first decision made it clear that the sum to be paid should have been paid by 12 February 2008. He said that while this may be wrong either in fact or law, following the case of *Bouygues v Dahl-Jenson*, the absence of any jurisdictional point in respect of decision 1 meant that the decision is binding and the sum is due and payable.

- There was no cross-application seeking to appeal the adjudicator's second decision, which had decided that the sum in the first adjudication was not caught by clause 7.2.3 and was due in any event. Again this decision was binding.

118. By way of comment the judge added that following the case of Levolux and others, an adjudicator's decision may have a different status to a certificate or an obligation to pay a specified sum under the contract.

119. Lastly, he observed that the adjudicator was probably right in concluding that the sum was due on 12 February 2008 and it was contrary to the terms of the contract and the Act that the employer could defeat a claim by reference to an event that occurred two-and-a-half months after the money should have been paid.

120. The clear implication of the decision usefully is that decisions of an adjudicator are binding in the absence of any jurisdictional arguments. The determination provisions within JCT Minor Works 1998 cannot be used to defeat a contractor's entitlement to be paid a sum that fell due before the determination, even though an adjudicator may have reached his decision as to that sum after the date of the

determination.

(8) Adjudication in the credit crunch: is it providing the answers?

121. The recent G20 summit may have succeeded in bringing a brief note of optimism to the financial situation with the pledge of $1.1 trillion to boost the international economy, but the long term prospects for many industries remain bleak for the foreseeable future. The fact that UK plc 'owned'[25] Lloyds Bank shut down Cheltenham & Gloucester Building Society in June is another marker of how far we have to go. In the US the number of banks which have failed in 2009 now totals 29, four more than the 25 that failed all of last year. The additional 4 failures will cost the Federal Deposit Insurance Corp's deposit insurance fund $698.4 million.

122. The construction and demolition sectors, and all the organisations allied to this marketplace, are bracing themselves for even tougher times ahead as the time lag of the boom wanes, despite some encouraging signs such as Nationwide reporting house prices rose by 0.9% in September, the fifth consecutive monthly increase. The simple fact remains - as I mention in the 'dash for cash' – that contractors will need to continue to operate at maximum efficiency to maintain healthy profit margins. Given that the housing market still faces considerable headwinds in the form of high unemployment, restrictive credit conditions and an impending withdrawal of the stamp duty holiday, it would be surprising to see house prices continuing to increase at the rate seen in recent months.

123. In these very difficult times it is interesting to see in the first paragraph of his judgment in *Able Construction (UK) Ltd v Forest Property Development Ltd* [2009] EWHC 159 (TCC), Mr Justice Coulson remarked that:

> This is an adjudication enforcement application under CPR Part 24 which raises a number of issues that are becoming a feature of these straightened times. From my particular vantage point, it appears that the current recession is providing the first real test of the adequacy of the adjudication regime introduced by the Housing Grants, Construction and Regeneration Act 1996 since the initial flurry of cases when the legislation first came into force..

124. Whilst the facts are not directly relevant, what was said by the judge about TCC policy and about the recoverable costs of enforcement shows that the Courts are not putting up with nonsense. In this case, Able had been engaged by Forest to carry out work on a residential development in Harrow. A dispute arose which was then referred to an adjudicator, who found in favour of Able in the sum of £166,464.33. The parties negotiated a settlement agreement, which provided that:

(i) Forest were to pay Able £150,000 in four instalments, in addition to the adjudicator's fee, which was due immediately;

(ii) The Agreement was in full and final settlement of all claims or liabilities in relation to the work, provided the Forest paid in full;

(iii) In the event that Forest failed to pay an instalment, Able could enforce the adjudicator's decision with full costs and interests.

[25] The taxpayer's stake in the bailed out bank is at 45.74%.

125. Forest paid the first instalment, but defaulted on the second, and consequently Able commenced court proceedings for the remaining £110,000. Mr Justice Coulson, even in the absence of Forest at the hearing agreed that, Able were entitled to judgment for the unpaid balance due of £110,000 pursuant to the original adjudicator's decision. Able were also awarded their claim in interest in accordance with the Late Payment of Commercial Debts (Interest) Act 1998, and their costs on an indemnity basis. This case should act as a clear warning to parties who have no real defence to a claim and are simply delaying payment of monies due. Indemnity costs are by no means unusual orders defendants collect at the pay desk.

126. Whilst indemnity costs are usually a rarity in most of the rest of the civil justice system and can generally be resisted in favour of standard basis costs, in adjudication enforcements in the TCC things are different if enforcement is resisted for uncompelling reasons. In the last three years or so, the TCC has taken a robust line in such cases. This started with a case called *Gray & Sons (Builders) (Bedford) Ltd. v The Essential Box Co. Ltd* and has been followed in *Harris Calnan Construction Co Ltd v Ridgewood (Kensington) Ltd*[26] and many others since like *Mead General Building Ltd v Dartmoor Properties Ltd*[27] referred to above in the context of CVAs.

127. In Harris Calnan Mr Justice Coulson said this:

> …The Claimant seeks an order for indemnity costs. Regrettably, it is not uncommon for a Defendant to fail to pay on the adjudicator's decision, thereby obliging the Claimant to issue enforcement proceedings. Thereafter, it is also not uncommon for the Defendant to refuse to co-operate such that the Claimant has to go to the expense of pursuing the enforcement proceedings through to this sort of summary judgment hearing. In Gray & Sons (Builders) (Bedford) Ltd. -v- The Essential Box Co. Ltd. [2006] EWHC 2520 (TCC) the Defendant adopted the same approach as the Defendant has adopted in the present case, albeit there, the day before the hearing, the Defendant indicated that it did not oppose the application for summary judgment. I concluded in Gray that an order for indemnity costs was appropriate. I said that the Defendant knew, or ought to have known, that it had no defence to the claim to enforce the decision and that it was unreasonable for the Defendant to continue to give the impression that the application was resisted, thereby causing the Claimant to incur costs…

128. Yet however robust the TCC has shown itself to be, parties will rightly remain worried about cash flow, particularly with the menace of insolvency threatening. The Government and ODA pledges[28] for the 2012 Olympics (and other projects like Cross Rail and the Thames Tunnel) will not be enough to save everyone.

129. So against this background is adjudication the right tool? Well, as most of us know, there is no legal procedure yet known to man for getting blood from a stone. My experience shows that a well versed client will know if there is a problem soon enough and it is best to act quickly. If you have security call it, if you have a right to suspend serve notice, but don't just hope things will get better. It is the time to engage even with "without prejudice" lines running in tandem and the Alternative Dispute Resolution door ajar.

26 [2008] BLR 636
27 [2009] EWHC 200 (TCC)
28 The Olympic Delivery Authority (ODA) has followed the Government's lead and has also announced it will pay suppliers promptly. Just before Christmas, the Times reported that the ODA will pay undisputed invoices within 18 days. In December 2008, at a "prompt payment summit", the Business Secretary, Lord Mandelson, launched a new *Code of Practice* aimed at increasing the speed of payments to small companies (SMEs). This summit followed an earlier Government *commitment* to pay its suppliers within 10 days.

(9) The leapfrog from decision to Petition in a day – watch the pips go squeak

130. In these days where time is of the essence there may be a more direct and possibly a more cost-effective course to recovering payment than conducting an adjudication and then proceeding to enforce the adjudicator's decision, or a fortiori marching to court or arbitral proceedings in the conventional way.

131. If one is to get recovery quickly, you will all know a device commonly used by a creditor to secure payment of an outstanding debt is the service of a good old statutory demand[29]. In the company context served in accordance with section 123 (1) of the Insolvency Act 1986.

132. However, there are situations where you can go straight to a Petition leapfrogging a statutory demand, say on a certificate absent a withholding notice or on a money default against an adjudicator's decision. So, just to be clear, the justification for such a course is that if there is a debt, which is unpaid, the explanation is that the debtor is unable to pay its debts as they fall due, i.e. the test for insolvency under s. 123(1) of the Insolvency Act 1986. Failure to pay a debt is evidence of inability to pay the debt. A statutory demand is not necessary; the creditor may proceed directly to present the winding-up petition, but a statutory demand, which is not met, provides prima facie evidence that the debtor is unable to pay its debts as they fall due.

133. Remember an adjudicator's decision/award has, for the purposes of insolvency, the same status as a judgment; if the adjudicator has jurisdiction, the Court will not look into the merits of his decision, so there is usually locus standi to present a winding up petition; *Parke v Fenton Gretton Partnership*[30].

134. The TCC judges have made it clear that summary judgment is normally the appropriate course for enforcement of an adjudicator's decision and in a straightforward case, this is a relatively quick and cost-effective process. The issue here is whether the potentially even more straightforward process of serving a statutory demand or lodge a petition compulsorily to wind up is a richer vein.

135. In *Jamil Mohammed v Dr Michael Bowles*[31], in *Parke v Fenton Gretton Partnership* and in *Guardi Shoes v Datum Contracts*[32], it was held, unsurprisingly, that an adjudicator's decision creates a debt. In *Jamil Mohammed v Bowles*, an application to set aside a statutory demand failed. There was no cross-claim. In *Guardi Shoes*, the creditor had obtained judgment as well as an adjudicator's decision. The debtor, Guardi, allegedly had cross-claims but these had not been pursued in accordance with the contractual machinery, although Guardi had had the opportunity so to pursue them. Guardi's application for an order restraining the creditor from advertising a winding-up petition failed.

136. There is therefore no objection in principle to serving a statutory demand and/or presenting a petition for liquidation / bankruptcy in the event that an adjudicator's award is not paid. This is exactly what happened in *Re a Debtor (No. 1299 of 2001)*[33] and *Re Environmental Services*[34].

137. While winding up of a debtor company is not in the interests of the creditor, the

29 On a statutory demand if the debt is not paid within three weeks or some arrangement is reached to the satisfaction of the creditor, then the debtor will be deemed unable to pay its debts under the statutory demand. This is one of a number of grounds set out in section 122 (1) of the Insolvency Act, which enables the court to wind up a company. The procedure under section 124 (1) of the Act for winding up requires the service by a creditor of a petition for winding up to the High Court.

30 (2001) CILL 1712, here the debtor with an adjudicator's decision against him succeeded in setting aside a statutory demand. He, however, had started proceedings in the TCC, which would have the effect, if successful, of reversing the adjudicator's decision. There was a genuine cross-claim which gave rise to a triable issue.

31 [2002] 394 SD 2002

32 [2002] CILL 1934

33 (2001) CILL 1745 GAL were roofing sub-contractors employed by CCL under a "construction contract" within the meaning of the Housing Grants, Construction and Regeneration Act 1996 ("the Act"). CCL withheld an interim payment due to defects with the roof and because GAL had used felt guttering instead of lead. No section 111 withholding notice was served because the defects only became known after the period for serving the notice had expired.
GAL served a statutory demand on CCL for the interim payment and threatened a winding-up petition.
CCL employed another sub-contractor to carry out remedial works to the roof. CCL contended that the cost of the remedial works and the reduction, to reflect the lower cost of the felt compared with the lead, significantly exceeded the debt claimed in the statutory demand. CCL sought a final injunction against GAL from presenting a winding-up petition on the basis that: (1) GAL did not have the necessary locus standi to present a petition because the debt was capable of a bona fide dispute; and (2) the grant of an injunction preventing the petition would otherwise be justified.
Is there a debt capable of bona fide dispute? David Donaldson Q.C sitting as a judge in the Chancery Division of the High Court found that, in the absence of a withholding notice, section 111 of the Act required CCL to pay the interim payment without deduction. Any right of set-off or cross claim provided no basis on which it can be disputed that the interim payment was due. GAL was regarded as a creditor of CCL with locus standi to present a winding-up petition.
Is the grant of an injunction otherwise justified? Following the Court of Appeal in *Seawind Tankers Corporation v Bayoil S.A.* [1999] the judge held that if CCL could establish that: (1) it had a genuine and serious cross claim that exceeded the petitioner's debt; and (2) it had not been able to litigate the claim; then the petition should be dismissed or stayed unless there were special circumstances.
First, the judge held that the fact that a debt falls within the Act cannot be viewed as a special circumstance in favour of a winding-up order. Secondly, the judge was unwilling to decide whether there was a genuine and serious cross claim due to the sketchy evidence. Thirdly, the judge found that CCL had had reasonable opportunity to litigate the matter through adjudication. CCL therefore failed on this final point. It had the opportunity to litigate the matter through adjudication but had failed to do so.
The court concluded that it was prevented from determining that the proposed winding-up petition had no real prospect of success. As a result, GAL were allowed to present such a petition and the court refused the injunction sought by CCL.

34 Unreported, November 14, 2004.

debtor may yield to the anxiety imposed by the statutory demand or the threat of the presentation of a winding-up petition. In a straightforward case, this is a route for consideration at least. In particular, this route is a matter for serious consideration where there is either no counterclaim, no counterclaim that overtops the claim or no genuine and serious counterclaim or cross-claim.

138. The case of *Medlock Products Limited v SCC Construction Limited*[35] provides confirmation that, in the right circumstances, a winding up petition can be the appropriate remedy where monies are due under a construction contract and there is no valid notice of withholding and no genuine cross-claim exceeding the debt to the contractor. There were issues in this case over whether Medlock Projects Limited or its subsidiary was the proper debtor, which we will ignore.

139. SCC was engaged as sub-contractor to Medlock on three different projects. On one contract, the Congleton contract, a settlement was reached whereby payment was to be made in two stages of £50,000 and £25,000. The first payment was made but the second was not made on time. Invoices rendered on the two other contracts were also not paid.

140. SCC commenced winding up proceedings. One of the procedures on winding up is to advertise the winding up petition. The advertisement of the petition can be financially damaging. Medlock applied to restrain the advertisement of the petition because there was a bona fide dispute or cross claims, which Medlock had not been able to litigate, exceeding the petition debt.

141. The court dismissed the application to restrain the advertisement of the petition. The court said that, to defeat a petition the dispute has to be a genuine one on substantial grounds and the cross claim has to be a bona fide cross-claim with a genuine prospect of success.

142. Very importantly, the court took into account the fact that the contracts were construction contracts with the requirement of a written withholding notice if monies were to be set-off. The judge stated, "I rely on the absence of any withholding notice therefore to support my conclusion that the cross-claims are not substantial and serious claims".

143. However, we might on the flip side today discuss HHJ Coulson QC's decision (as he then was) in *Harlow & Milner Ltd v Teasdale*[36], in which he gave summary judgment to enforce an adjudicator's decision. He also had to deal with an application by the claimant for costs incurred in bankruptcy proceedings when a statutory demand was set aside by consent and the issue of costs was reserved to a TCC judge. The background to this was that the claimant apparently originally sought to enforce an adjudicator's decision by statutory demand and bankruptcy proceedings and then switched to summary judgment in the TCC.

144. In deciding to make no order as to the costs of the bankruptcy proceedings, Judge Coulson made some obiter comments, which appear to be intended to discourage the use of the statutory demand/winding-up petition route:

35 [2006] CILL 2384, significantly, the court placed great weight on the absence of a withholding notice in finding that there was no genuine cross-claim. The application to restrain the advertisement was dismissed.

36 [2006] EWHC 535 (TCC). Brought to my attention by Peter Sheridan and Dominic Helps excellent piece in Construction Law Journal (2008) Vol. 24.

> ... it is not easy for me to understand why the bankruptcy proceedings were issued. In my judgment, the appropriate way of enforcing the adjudicator's decision was to issue enforcement proceedings in the TCC. If the proceedings had been issued in June, the Claimant would have had his money in July, and a good deal of time and costs would therefore have been saved. Of course, I quite accept what Mt Mort says, that the issue of a bankruptcy petition was not of itself the wrong way of enforcing these proceedings. On the other hand, given that there is a procedure expressly tailored by the TCC to allow the prompt and efficient enforcement of adjudicators' decisions, the court has to consider very carefully an application for the costs of other proceedings, commenced in addition to the enforcement claim, particularly in circumstances where, in the end, it was the enforcement route that has proved to be the right course …

145. He went on obiter:

> It is important that all parties to adjudication realise that save in exceptional circumstances, the most efficient way of enforcing the adjudicator's decision is by enforcement proceedings in the TCC. Other ways of enforcing such decisions (such as, for instance, bankruptcy proceedings) are something of a blunt instrument and raise potential issues which have little or nothing to do with the decision which is at the heart of any enforcement application. Ordinarily, therefore, the issue of a statutory demand will not be the appropriate means of enforcing an adjudicator's decision…

146. I think it is fair to say the path Judge Coulson warned against was, it seems, taken without express consideration of all authorities and was successfully taken in *Jamil Mohammed v Bowles* and *Guardi Shoes*. What "potential issues" are raised will depend on the facts of the case. Judge Coulson's remarks also entreat the question of what the exceptions will be to the position applicable "ordinarily". As indicated above, I suggest, and I am not alone on this, that a major factor will be whether there is a counterclaim. A point for debate tonight, maybe?

(10) Vesting Certificates v advance payment bonds

147. When lead in times are long, like on vertical transportation, curtain walling, Thassos marble, granite baths, heated self cleaning toilets from Japan etc etc clients take larger risks to secure materials.

148. Indeed, in certain circumstances, an employer is requested to make an advance payment for materials (common on EPC contracts) before they are delivered to the site. Alternatively, an amount may be included in an interim application for payment for materials that are off site. Advance payment is usually sought where a contractor or supplier is outlaying significant expenditure on larger items of plant or equipment and requires some payment, notwithstanding the fact that it is not yet entitled to be paid under the contractual certification procedure. In the EPC world bonding is common[37], but not so construction. It is far better to get protection at the outset than rely on the uncertain arrows of adjudication to sort out entitlement later on.

149. It can never be completely safe to pay for materials and goods that are not stored on site, even less so for unfabricated materials and goods like rebar, but that does not mean clients should never do it. Often our industry focuses on the wrong questions when it looks at this issue.

150. Project managers are fixated on hitting the programme. They see it as essential to 'reserve the materials', and this leads them to conclude that a payment must be made, even if not delivered to the site.

151. What the industry tends to do in practice to protect the client is to request the contractor to sign a "vesting certificate" or "vesting agreement" or "certificate of vesting" to verify that the materials will pass to the client, that they are separately stored and designated by marking up on the client's premises, that they are insured and so forth. Once the vesting agreement has been issued, they inform the client to issue the cheque. I have seen the perils caused with the pre purchase of rebar to hedge against rising steel prices to find the same steel vested many times over to different purchasers!

152. On the other hand, a vesting certificate unlike an advance payment bond only compels the supplier or contractor to ensure that, when entering into arrangements with its suppliers or third parties, materials shall not be subject to any retention of title by those parties. Such certificates expressly provide that, regardless of whether materials have been delivered to site, they form the employer's property and that title to those materials is vested in the employer. A vesting certificate is less robust than an advance payment bond in that if the supplier breaches the conditions of the vesting certificate or becomes insolvent, the employer's remedy would be reduced to damages for breach of contract against the supplier and the materials themselves may be lost. One of the main benefits of a vesting certificate is that it can be relied upon to defeat liens or claims of retention of title in the materials by the contractor or a third party.

153. However, even in the case of fabricated goods like ironwork, palletised chillers, and escalators and even if the goods are separately stored, marked and checked

[37] In circumstances where an employer makes an advance payment, it is prudent for it to ensure that it receives an advance payment bond from the party to whom the payment is being advanced. A bond will provide protection against the risk of insolvency of the party taking possession of the materials. Generally speaking, an advance payment bond is a robust form of security, in that a third party – the surety – agrees to pay the employer the agreed value of the materials upon receipt of a written demand. An on-demand advance payment bond is no-fault and the surety is compelled to pay the sum regardless of the timing of the employer's demand, notwithstanding any financial difficulties on the part of the supplier or the status of the materials being held.

as the client's premises if a contractor becomes insolvent or there are rumours of insolvency, the goods may simply go walkies, and even the most indelible marking of the client's name may be removed, even when wired on and sprayed on the dockside or on a concrete apron.

154. Besides, the unfabricated materials that are earmarked for the client are unlikely to become its property anyway, whatever the vesting certificate says. In the contractor's yard they will be mixed with materials from other suppliers as they cannot be stored apart and marked if they are then to be worked with. In such circumstances, again, if the contractor is rumoured to be on the verge of insolvency, the materials can disappear.

155. If the materials or goods, whether fabricated or not, are located abroad, who knows what local laws say about the passing of property? Do we know whether the laws in, say, Korea, demand that property passes to those that made the payment or require those that receive goods marked as someone else's property to return them to the owner?

156. Furthermore, what value is a vesting certificate signed by a contractor that has gone belly up? Suing an insolvent contractor for breach of a vesting certificate is not likely to be fruitful.

157. So what should clients ask in these circumstances?

158. First, it is important to look at the overall financial standing of the contractor. Does it have a sound balance sheet? If it is part of a bigger group, should an ultimate guarantee be requested from the holding company? Is there a performance bond that might make some contribution to the client's loss if the goods and materials disappear?

159. In addition, if the payment is for securing materials that are then to be worked on in the contractor's yard, is the payment really an advance payment to the contractor? If it is, should it then be secured by an on-demand bank guarantee?

160. Might it be better if the client entered into a supply contract with the materials supplier, with this being passed across to the contractor when it is appointed? In those circumstances if the client fails to agree the commercial terms with the contractor, it has at least still secured its materials.

161. Alternatively, is the commercial arrangement really just an undertaking by the client to pay a specific cancellation charge if, for some reason, the contractor does not proceed, so that the supplier is compensated for the lost sale?

162. Clients need to look more flexibly at how they buy from the construction industry in periods of lack of capacity. Ultimately, the judgement as to whether, how much and when to pay is a commercial one. Instead, when buying materials, the industry tends to stack up a legal pack of cards that collapses as soon as there is an insolvency.

(11) The commonly overlooked rule in *Day v McLea*

163. Cash flow has been my mantra as the life-blood of many small businesses and the sending of a cheque for a lesser sum than the claim purporting to be in full and final settlement, may, in reality, be no more than an attempt to put pressure on the creditor in need of an immediate injection of revenue. I want to consider a 'rule' often over looked which can be a darling of the quick self help[38] kind.

164. Arguments over money between contracting parties in the construction industry are a common occurrence. It is also not unusual for one party to offer to pay a lesser sum in "full and final settlement" in order to avoid legal proceedings and for the other party to accept this offer. Does this sound familiar? So far so good, but what then happens if the party receiving the money changes its mind and decides to pursue the balance. Does it have a valid legal claim?

165. Whether the parties will be stuck with their settlement bargain depends on a number of factors. The legal principle that has to be considered here is referred to as "accord and satisfaction". In summary, for an agreement for one party to pay and for another to receive a lesser sum than that which would otherwise be due under the terms of a contract, there has to be agreement (the accord) and crucially some further consideration (the satisfaction) moving between the parties.

166. An important lesson arises when scrutinising the practical law applicable to tendering cheques in purported final settlement. Can you take a part-payment offered as final? Can you retain the right to claim the full sum?

167. It is not uncommon for an employer to seek to pay his contractor (and a main contractor his subbie) less than the full contract sum if there is a dispute as to compliance with the contract. If each party accepts such an unsatisfactory situation, its original legal rights may be released by a process known as accord and satisfaction. In such a situation, there must be consideration - a quid pro quo - for something promised or done.

168. Thus, if Flat Broke, a contractor, agrees his window installation is not up to the contract tolerances, and Vertically Challenged, the employer, is prepared to accept such inferior works, then their agreement to conclude their mutual obligations on payment of a lesser sum by Hardy would be a perfectly good accord and satisfaction and would release each party from the contract. However, the agreement will not be binding per se; there must be an agreement under seal or supported by fresh consideration, for example an abatement in price.

169. This principle can be traced back as far as 1602. In construction, the principle was aired before the Court of Appeal 40 years ago in the case of *D&C Builders v Rees* (1966). The plaintiff carried out work worth £482 for the defendant. The plaintiff pressed for payment for months. Finally, the defendant's wife, who knew the plaintiff was in financial difficulties, offered £300 to settle the debt, saying that if the offer was not accepted, nothing would be paid. The plaintiff accepted a cheque for £300 and gave a receipt "in completion of the account". It later sued for the balance and the question arose whether the action was barred by accord and satisfaction. The court ruled that the plaintiff was not barred from recovering the balance, as

38 Remember the mere fact that a judicial remedy may be available does not render a remedy of self-help unavailable. Indeed, a party may even be entitled to a remedy of self-help at a time when he is seeking substantially the same remedy from the courts. In *Re Lonrho Plc* [1989] 3 WLR 535 the House of Lords considered and rejected the argument that it would be a contempt of court for a litigant to secure by means of self-help a benefit that he also seeks by litigation: *"In the light of these apparent anomalies we must ask whether there is any support in principle or authority for the proposition that a litigant who seeks a judicial remedy compelling a certain course of action creates a risk that the course of justice in the proceedings in which the remedy is sought would be impeded or prejudiced if he takes direct action to secure for himself the substance of the remedy sought without the assistance of the court. The example was put in the course of argument of the plaintiff who complains that his neighbour has built a wall obstructing his right of way and seeks an injunction to have it removed. He succeeds at first instance, loses in the Court of Appeal and appeals to the House of Lords. While the appeal is still pending he loses patience and knocks the wall down. In this example, if the plaintiff succeeds in the appeal, he will no longer need a mandatory injunction. If he loses, he will have rendered himself liable in damages and possibly criminally. In either event, however deplorable his conduct, it is difficult to see how the course of justice, in determining the legal rights of the parties is likely to have been impeded or prejudiced in any way. It is easy to think of many other examples of litigants resorting to this kind of self-help."*

there was no accord. The plaintiff's consent had been obtained under pressure. The defendant argued unsuccessfully that the principle of equitable estoppel applied to make the plaintiffs "acceptance" binding.

170. This principle has been applied to cases where a creditor agrees to accept a lesser sum in discharge of a greater sum. However, there is a qualification to applying this principle. The creditor is barred from asserting his rights only when it would be inequitable for him to insist on them. Where the creditor agrees to accept a lesser sum, and the debtor pays the lesser sum, it is then inequitable for the creditor to insist on the balance.

171. In the *D&C Builders* case there was found to be no true accord. The debtor's wife held the builder to ransom. The builder was in need of money to meet his own commitments, as the debtor knew.

172. In *Day v McLea* (1889)[39], a similar point arose. A defendant sent a cheque for a lesser sum than that claimed for breach of contract "in full of all demands" and enclosed a receipt in that form for signature. The creditor instead sent a receipt "on account" and banked the cheque. The Court of Appeal held that there was no accord to bar the claim.

173. In *Stour Valley Builders v Stuart*[40] (1993) the court decided that whilst the cashing of a cheque that that been accompanied by the statement "in full and final settlement" was strong evidence of "accord" it was not in itself conclusive evidence. In theory a contractor could still cash a cheque in such circumstances and keep alive its claim for the balance provided its intentions were immediately made clear to the defendant and the claim for the balance was pursued without delay.

174. More recently, the Court of Appeal has again approved the doctrine in the context of an open offer sought to be made by a defendant in "full and final" payment of a larger debt in *Ferguson v Davies*[41].

175. Therefore, there are at least three bases on which the claimant may be able to pursue a claim for the balance if he has banked the cheque. First, if there was no dispute about liability for the sum that was paid, then there can be no consideration to support any contract by way of accord and satisfaction in respect of the balance.

176. Second, even if the defendant has put all of his liability into dispute, then it seems that the plaintiff can bank the cheque and write to the defendant saying he is accepting the cheque, not in full and final satisfaction, but on account.

177. Further, if the cheque was banked by an employee of the plaintiff company with authority to bank cheques but without authority to compromise claims, then again there can be no binding contract of accord and satisfaction.

39 [1889] 22 QB 610
40 Times, 22 February 1993
41 (1996) CILL 1208

(12) The view from the Aldwych on this crunch

178. I can tell you that people are busy dealing with more disputes and pre-action advice. An increase in the use of letters before action and statutory demands as a way of trying to get money owed is apparent, even though this option is limited in application.

179. Many more parties are becoming insolvent; more publicly funded parties (such as those involved in PPP/PFI projects) are adjudicating, as well as companies and individuals. Practical Completion is more elusive as is the conditionality of making good defects!

180. Many more determinations and suspensions are invoked not simply notices served reserving the right to do so.

181. Certainly, the TCC has been busy in the last few months dealing with adjudication enforcement applications and I have noticed a swell in the challenge to and enforcement of adjudicators' decisions. It has even resulted in a developing area of case law: the recent trend of one party seeking declarations from the court during the adjudication, like in *Dorchester Hotel v Vivid Interiors*.

182. It is not just adjudication disputes that are on the rise. *Construction News* recently reported that Mr Justice Coulson has a heavy particularly caseload. At a recent hearing, he advised Carillion that the Bath Spa case "may not go as quickly as some hoped", with preliminary matters not likely to happen until "sometime in the middle of the year": meaning the court's summer term.

183. It is clear that the chilly economic climate will last until well into 2010. Where there is an increased likelihood of contractors or employers going 'belly up', the provisions of the contract detailing what happens in such circumstances gain heightened significance. This creates significant risks for parties to construction contracts as some of us saw all too well in the last recession, with the obvious weaknesses of contractors and employers to cash-flow difficulties and insolvency and falling order books and CVRs[42]. These risks increase the importance of the contract provisions in the five areas outlined below. Look at them and review them every time you bid and keep them up on the radar; they are worth being on top of every time you step on the merry-go-round:

- Where cash-flow becomes an issue in the course of a project – for example where a contractor needs to purchase materials to complete the job before he has received payment for that job – the provisions in the contract regarding the circumstances in which advance payments, escrows, pre-purchase deeds can be made also become highly relevant;

- Where the project runs into difficulties, and is stopped part-completed, the question of ownership of the materials used becomes important, as they may be of considerable value to one or all parties; ditto step in rights of funders and the advent of a 'new' client in the shape of a bank with distressed assets;

- The provisions on suspension are dusted off and inspected to see if they are

[42] For those that do not know, CVR is the traditional practice of determining and reporting profitability of a construction project on a regular basis. By comparing of costs with value (revenue) at a certain date, you can see the difference between the cumulative profit or loss on the project.

sufficient stick to call a tardy paying employer into line, often they are not worth the candle of pulling off for the heavier engineering packages and this can be where the biggest holes are burnt in pockets;

- The provisions on termination/determination in the contract detailing how, in what circumstances, and how quickly a party can end the contract or its employment in the face of default by the other party;
- If a contractor is struggling to balance the books, it is inevitable that they will fight hard over any disputed sums in a contract. This can lead to protracted and increasingly bitter litigation. The provisions of the contract relating to dispute resolution will therefore be highly relevant to the success with which the parties are able to remedy the dispute without incurring high litigation costs.

184. One thing is sure; these areas of domestic contracts will be fertile in the trough we have descended into in large parts of the industry. The next decade will be very different from the last for sure!

Funders and step-in rights

185. Funders are getting closer to exercising their step-in rights. A few are screwing deals up or looking at ways to keep projects going at minimum cost (and minimum loss). Non-contentious construction lawyers may love to talk about step-in rights, but they are rarely used in practice, particularly with toxic assets mounting amongst some desperate banks. Will this recession result in another legal development, as funders have no choice but to exercise their step-in rights? No doubt opportunities for the FM industry.

Checklist

186. I offer the following checklist for employers (and main contractors looking downstream) it is not meant to be exhaustive and should only be considered as a supportive tool (as every situation will be different), but in general terms, to look after your position in the event of contractor insolvency, employers should take care that their contract contains:

    - a wide definition of insolvency to cover as many different default and business failure scenarios as possible;
    - a right to suspend the obligation to make payments to the contractor following the occurrence of any insolvency event;
    - early insolvency triggers to give you as much time as possible to consider your position if the contractor's business starts to go bad;
    - no automatic termination of the contract on the insolvency of the contractor (to provide flexibility and allow you to liaise with the contractor's insolvency practitioner);
    - provisions in the main contract and sub-contracts that deal with the passing to you of title to on-site and off-site materials in the event of the contractor's insolvency;
    - provisions which allow project continuation through the use of collateral warranties/third party rights from sub-contractors (which should include "step in" rights);
    - payment clauses which ensure that you pay in arrears and only pay for the value of works performed. If this is not possible (e.g. where an advance payment needs to be made for a special item), then consider securing the payment by requiring an on-demand bond (although this will involve a financial cost and the securing of a vesting certificate);
    - provisions which give you the power to continue the project after termination (including the rights to use plant, equipment, materials and drawings, but be careful in situations where the contractor does not own them);
    - for extra protection, it is ideal to have a clause requiring that the contractor provide you with a performance bond or a parent company guarantee (or both); these are "must-haves";
    - if you relinquish requiring a performance bond at the start, then you should consider whether you should include a provision which specifies that the contractor must provide you with a performance bond on receipt of a written demand with a right to terminate if it is not provided by a specified deadline;

- provision that the contractor must ensure that any sub-contracts are "back-to-back" with the main contract and provide evidence that the sub-contracts do not contain any retention of title clauses in relation to any materials being used by the contractor; and

- if you will be paying for any off-site materials:

  – a stipulation that the contractor is required to identify clearly where any off-site materials are to be manufactured or kept;

  – a stipulation that the contractor must ensure that the off-site materials are stored separately and clearly marked as your property;

  – a condition that the contractor will provide you with an on-demand bond before you will pay for any materials being held off-site to prevent any risk that such materials are not delivered to your site; and

  – a obligation that the contractor provides a vesting certificate from the owner of the off-site materials and any intermediary owner confirming that upon payment, title will pass to you.

Conclusion

187. In an increasingly difficult market, it pays to be vigilant. To protect yourself against the problems of rising contractor insolvencies, you should ensure that your contract contains suitable provisions to deal with insolvency and its consequences, keep alert for early indications that your contractor may be in trouble and, if you are worried that your contractor or subbie is failing, adopt a cautious approach before deciding what steps to take in order to minimise the impact.

The future

188. With the recession showing no true sign of abating quite yet, we can only guess how long these trends will continue. However, for those here tonight there should be enough bread at our tables!

October 2009