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Inside this issue

Adjudication Costs: The law of diminishing returns?

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For a dispute resolution method designed to deal "*expeditiously and relatively inexpensively with disputes*"[1] adjudication can, unfortunately, be expensive. Since the introduction of section 108A into the Housing Grants, Construction and Regeneration Act 1996 by the Local Democracy, Economic Development and Construction Act 2009 (together the "**Housing Grants Act**") parties have tried a variety of ever more inventive tactics to try and recoup their costs.

In this *Insight* we examine the merits of the various arguments we have seen parties seek to use to recover their costs in recent years and ask if any of them are, in reality, likely to succeed. Before doing that, we take a look at what section 108A of the Housing Grants Act actually says.

Adjudication Costs: The law of diminishing returns?

Section 108A of the Act

Section 108A of the amended Housing Grants Act provides that:

> "*(1) This section applies in relation to any contractual provision made between the parties to a construction contract which concerns the allocation as between those parties of costs relating to the adjudication of a dispute arising under the construction contract.*
>
> *(2) The contractual provision referred to in subsection (1) is ineffective unless –*
>
> *(a) it is made in writing, is contained in the construction contract and confers power on the adjudicator to allocate his fees and expenses as between the parties, or*
>
> *(b) it is made in writing after the giving of notice of intention to refer the dispute to adjudication.*"

This section was designed by the government to outlaw Tolent clauses which the courts had already held were a fetter on a party's right to adjudicate at any time.[2] The question is, though, does section 108A achieve this? It is generally considered that this wording would be interpreted by the courts as preventing the parties from agreeing that an adjudicator can allocate party costs (resulting in them having to be borne by the party who incurs them) unless the agreement is made *after* an adjudication is started. As practitioners will know, the chances of agreeing that party costs can be allocated after an adjudication is commenced are remote.

However, the wording of section 108A has not yet been tested by the courts and has been criticised as "*unfortunate*"[3] and "*inept*"[4] by leading commentators. They suggest the wording could arguably allow parties to allocate their fees by agreement before any adjudication commences as long as they also allow the adjudicator to allocate his fees and expenses at the same time.

There remains, therefore, a possibility that the wording of section 108A may be challenged by the courts at some stage, albeit this would, one assumes, grow more remote as time passes. In practice, parties seem to acknowledge that the intention of section 108A would in all likelihood be enforced if challenged and Tolent clauses have all but been abandoned.

Further, while the Scheme is silent on the allocation of the parties' costs, other rules are not. For example, the TeCSA Rules provide that the parties can give the adjudicator jurisdiction to allocate the parties' costs after the notice has been issued, and also provide expressly that the adjudicator shall have no jurisdiction to require the party that referred the dispute to adjudication to pay the costs of any other party solely by reason of having referred the dispute to adjudication.[5] As such, by agreeing to these rules parties are, in any event, upholding the intent of section 108A.

If an express agreement to allow the adjudicator to allocate interparty adjudication costs is, in practice, unlikely, are there then any other methods for recovering adjudication costs?

Late Payment of Commercial Debts (Interest) Act

The current hot favourite, which has re-emerged as a result of a recent case, is arguing that adjudication costs are recoverable under the Late Payment of Commercial Debts (Interest) Act (the "**Late Payment Act**").

In the case of *Lulu Construction v Mulalley & Co Limited*,[6] in adjudicator's decision, including an award of "*debt recovery costs*" for £47,666.27 pursuant to the Late Payment Act, was enforced by the Deputy Judge, Mr Jonathan Acton-Davies QC. However, a review of the 10-paragraph judgment shows that the issue addressed was not whether the entitlement had in fact arisen in the first place (the adjudicator could have been wrong in law and the decision would still have been enforced), but whether the adjudicator had jurisdiction to look at whether those costs could be awarded in the first place. Mr Acton-Davies held that the adjudicator did have jurisdiction:

> "*although it was not within the scope of the referral, it was something which was connected with and ancillary to that referred dispute.*"

In this case the referring party was not the one seeking recovery of the costs in question and as such they had been raised as part of the respondent's defence to the claims.

If an adjudicator holds that the Late Payment Act applies, and allows the recovery of adjudication costs as a result (be that right or wrong as a matter of law), then that on its own does not make his decision unenforceable. An adjudicator can be wrong as a matter of fact and/or law and his decision will still be enforced. There would have to be another separate reason for not enforcing the decision. There was no other reason in *Lulu Construction v Mulalley & Co Limited*.[7]

The question that remains unresolved is therefore whether it is correct as a matter of law that adjudication costs can be recovered under the Late Payment Act where it applies.[8] This has been the subject of much debate.

The key section of the Late Payment Act, for the purposes of recovering adjudication costs, is section 5A(2A). This provides:

> *"(2A) If the reasonable costs of the **supplier** in recovering the debt are not met by the fixed sum, the **supplier** shall also be entitled to a sum equivalent to the difference between the fixed sum and those costs* [emphasis added]."

The fixed sum is only a maximum £100 for debts in excess of £10,000 so the chances are any adjudication costs will comfortably exceed that amount pretty much the minute they are contemplated.

The first point to note is that if the parties agree a contractual remedy for late payment of the debt that is a substantial remedy, statutory interest is not carried by the debt (unless they agree otherwise). This means that under section 5A (1) the costs of recovering the debt are not recoverable under the Late Payment Act.[9] The courts have previously held that the provisions of interest within the JCT standard form are a substantial remedy,[10] so there may be limited scope for claiming that costs under section 5A can be recovered in any event.

The second point is that there is an ongoing debate as to whether the provisions of section 108A of the Housing Grants Act conflict with section 5A of the Late Payment Act and, if so, which one takes priority. Some have argued that section 5A implements an EU Directive[11] which should take priority over national law.[12] Given that Brexit will shortly be upon us it seems unlikely that the courts would be keen to override the Housing Grants Act and, in any event, EU Directives have vertical effect so making this argument may be difficult unless the adjudication was a government body for example.[13] In short, the author's view is that it is unlikely that the Late Payments Act would allow the recovery of adjudication costs but this remains to be tested by the courts.

Finally, we are aware of reports that some adjudicators have used the Late Payment Act to award purchasers their costs and not just suppliers. It should be noted that section 5A of the Late Payment Act applies to suppliers only. It does not provide a remedy for purchasers to recover their costs.

Claiming adjudication costs as additional project management costs and/or damages

Another tactic we have seen recently in adjudications is to try and claim the costs of preparing for an adjudication as the costs of assessing the final account and additional project management costs. The purported reason for doing this is that the contractor's failure to produce the information required to assess the final account "properly" has resulted in additional project management costs being incurred in assessing the final account. (Such claims are made notwithstanding the fact that the employer has assessed the account but has decided to dismiss it.)

The likelihood of such an argument being given much time should, one would hope, be very low. As a matter of analysis the costs of assessing the contractor's account should obviously be borne by an employer not the contractor who is submitting it unless there is express provision to the contrary in the contract (which seems unlikely). To argue that the presentation of an account, even where amended and resubmitted, results in additional costs to an employer which can somehow be recovered as damages under a construction contract should, this author contends, be dismissed out of hand on two grounds. First, unless otherwise expressly agreed (the costs of assessing an account fall squarely on the shoulders of an employer, or a contractor where it is a subcontractor's account). Second, this is a slippery slope to allowing a party's costs for an adjudication to be recovered, which is contrary to section 108A of the Housing Grants Act unless expressly agreed after the commencement of an adjudication.

Should it be accepted as an argument, unscrupulous employers could use this as an additional stick to threaten a contractor into settling a final account for less than is due. In any event, if in reality the costs claimed in this way are adjudication costs they should be rejected outright as irrecoverable pursuant to the Housing Grants Act unless there is an agreement to the contrary after the commencement of the adjudication.

So if this argument doesn't stand up to proper analysis, what else is available?

Subsequent recovery of costs against a third party

In some limited cases, it may be possible to recover adjudication costs incurred in fighting an adjudication from a third party in the form of damages. In *The Board of Trustees National Museums and Galleries* on *Merseyside v AEW Architects and Designers Ltd*,[14] Mr Justice Akenhead held that the costs of a previous adjudication against a contractor caused by negligent design by the architect were recoverable. He stated:

> *"I have formed the view that these costs are recoverable. If AEW had done its job properly in the first place, it is inconceivable that there would have been any adjudication in relation to the design responsibility of the Contractor because the issue simply would not have arisen: there would have been no problem with the geometry, the reinforcement or the gaps; there would have been no need for any suspension and there would have been no delay attributable to the steps and seats in 2010 and 2011. Adjudication is a fact of life now in construction contracts, albeit that it is not invoked on every project. It was within the bounds of reasonable foreseeability that there could be adjudication in circumstances such as arose here. There was a sufficient causative link between the defaults of AEW and this adjudication. The causative link would only be broken if the Museum had acted unreasonably or if its solicitors had acted negligently in advising the Museum that it had an arguable defence in the adjudication* [emphasis added]."

This case potentially leaves open the option of seeking to recover adjudication costs against a third party as damages is a wider variety of circumstances than just a case where the architect was negligent in their design obligations. For example, what if a QS had negligently failed to issue a pay less notice and this results in an adjudication by a subcontractor or contractor against the employer/contractor? There are potentially a range of circumstances in which costs could be claimed against others at a later date if a breach by a third party has caused an adjudication and its costs to be incurred. Proving causation would, however, be key to the success of any such claim.

Part 36 offer of settlement which covers adjudication costs

It appears that some parties have also sought to recover their adjudication costs in subsequent or parallel legal proceedings, opening up the results of the adjudication (i.e. not the enforcement proceedings). In other words, they have sought to include adjudication costs as part of the costs of the legal proceedings.

This was given short shrift in the recent case of *WES Futures Limited v Allen Wilson Construction Limited*,[15] which looked at whether a purported Part 36 offer included adjudication costs. Mr Justice Coulson noted:

> *"If this was a Part 36 offer, the analysis is straightforward. Rule 36.13(1) refers to the claimant recovering 'the costs of the proceedings'. That was the subject of the part 36 offer, and that was what was accepted. That means the cost of the court proceedings, threatened in February but not actually commenced until later. It is, I think, agreed that the costs of the adjudications are not costs of the proceedings.* ***So if this was a part 36 offer, it would exclude the costs of both the earlier and the later adjudications, which would not be recoverable*** [emphasis added]."

He concluded by emphasising that costs of proceedings in the context of court proceedings will not normally include the costs of separate, stand-alone ADR proceedings such as adjudication.[16] As such, a valid Part 36 offer made to include pre-action costs cannot include adjudication costs within it and this door to recovery is also closed.

Overview

In summary, despite the recent judgment of *Lulu Construction v Mulalley & Co Limited*,[17] the prospects of recovering your adjudication costs remain remote. With the exception of the possibility of recovering them from a third party who caused the adjudication in the first place, there remain limited arguments available to parties who seek to circumvent the intention of section 108A of the Housing Grants Act.

Whether the policy of not allowing adjudicators to apportion party costs, unless expressly agreed after the commencement of adjudication, is a good one is a matter of personal opinion. However, whilst adjudication can be expensive, the very fact that costs are not recoverable serves to act as an incentive to all those involved to minimise their costs wherever possible. This should strengthen the underlying goal of adjudication to be fast and inexpensive.

For complex claims that are likely to have very high costs associated with them, then the referring party should always seriously consider the option of initiating the pre-action protocol and then proceedings if required. Whilst it may take longer to get your money back (albeit the new pre-action protocol is considerably shorter than it was previously), the costs of doing so will be recoverable from the other side. That is ultimately a commercial decision.

Footnotes

1. See Lord Ackner's speech in the House of Lords on 22 April 1996 as per Hansard, 22.4.96, columns 989-990, and see also Peter Coulson QC, *Coulson on Construction Adjudication*, third edition ("**Coulson**"), chapter 1 for a discussion of the purpose of the Housing Grants Construction and Regeneration Act 1996 more generally.
2. See Ms Winterton's statements in the House of Lords on behalf of the Government on 13 October 2009 (column 172 of Hansard) in which she stated: *"Clause 137 inserts new section 108A into the 1996 Act, preventing parties to construction contracts from entering into agreements before a dispute has arisen about who should pick up the costs of an adjudication. As a consequence of this broad and simple prohibition, pre-dispute agreements between parties, to the effect that an adjudicator can allocate fees and expenses as part of his decision, will also be caught. Allowing the parties to agree in their construction contract that the adjudicator has this power is current good practice, which we would like to preserve. Amendment 22 achieves that by carving out such agreements from the general prohibition." See also Rachel Gwilliam's SCL paper dated July 2016 on "Recovering Adjudication Costs under the Late Payment of Commercial Debts (Interest) Act".*
3. See *Keating on Construction Contracts*, Sweet & Maxwell, chapter 18-05.
4. See Coulson, chapter 10.18.
5. See the TeCSA Adjudication Rules 25 and 26.
6. [2016] EWHC 1852 (TCC).
7. [2016] EWHC 1852 (TCC).
8. A detailed analysis of the Late Payment Act is beyond the scope of this article but by way of background, section 2 (1) of the Late Payment Act provides that the Late Payment Act *"applies to a contract for the supply of goods or services where the purchaser and the supplier are each acting in the course of a business, other than an excepted contract".*
9. Section 5A (1) provides that: *"Once statutory interest begins to run in relation to a qualifying debt, the supplier shall be entitled to a fixed sum (in addition to the statutory interest on the debt)."*
10. See *Yuanda (UK) Co Ltd v WW Gear Construction [2010] EWHC 720 (TCC); see also Walter Lilly & Co Ltd v Giles Patrick Cyril Mackay and another* [2012] EWHC 1773 (TCC).
11. Directive 2011/7/EU of the European Parliament.
12. See Rachel Gwilliam, "Recovering Adjudication Costs under the Late Payment of Commercial Debts (Interest) Act", July 2016 (SCL Paper 201).
13. For more detailed analysis see ibid.
14. *PIHL UK Limited and Galliford Try Construction Limited (trading together in partnership as a Joint Venture "PIHL Galliford Try JV")* [2013] EWHC 2403 (TCC).
15. [2016] EWHC 2863 (TCC).
16. Mr Justice Coulson cited ***Roundstone Nurseries Limited v. Stevenson Holdings Limited*** [2009] EWHC 1431 (TCC) in support of this (see paragraph 18 of his judgment.
17. [2016] EWHC 1852 (TCC).

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