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Nicholas Gould and James Mullen consider the impact on parties to construction contracts of recent court rulings concerning an adjudicator's right to recover fees, *ad hoc* agreements and set-off

In *Clark Electrical Ltd v JMD Developments (UK) Ltd* [2012] EWHC 2627 (TCC), the court was asked to determine whether an adjudicator had jurisdiction by way of an *ad hoc* adjudication agreement between the parties. The adjudicator's terms of appointment had included a provision that both parties pay a £6,000 appointment fee as security. Following his appointment, JMD sent an email to the adjudicator stating that:

- it was unfamiliar with the adjudication protocols, it was unrepresented and therefore requested guidance on the procedures and its responsibility
- it had not received the adjudication notice or supporting documentation from CEL and therefore requested an extension of time
- it requested the adjudicator's proposals for moving forward.

A few days later, JMD paid the appointment fee and then instructed a consultancy firm to act on its behalf. A dispute subsequently arose, with both parties focusing on whether the adjudicator had statutory jurisdiction. JMD argued that the works were not 'construction operations' and were excluded under Section 105 of the Housing Grants, Construction and Regeneration Act 1996 (HGCRA).

The adjudicator had issued a 'non-binding' decision on his jurisdiction, concluding that he did not have statutory jurisdiction. Instead, he unilaterally decided that he had jurisdiction by way of an *ad hoc* adjudication agreement between the parties, the terms of which were contained in his appointment that had been accepted by the parties' conduct when it paid the appointment fee. JMD promptly withdrew from the process and the adjudicator issued an award in CEL's favour.

At the enforcement hearing, CEL argued that JMD had submitted to the adjudicator's jurisdiction in the full sense and relied on JMD's email and its payment of the appointment fee. JMD argued that payment of the appointment fee did not demonstrate an *ad hoc* agreement to abide by the adjudicator's decision in the full sense; a party can still be liable for an adjudicator's fee where there is a legitimate challenge to the jurisdiction. As to the email, it was simply a request for guidance on the adjudication procedure and a request for more time to deal with matters where it had not yet received the relevant documents. The judge accepted JMD's argument, concluding that the adjudicator's decision on jurisdiction based on an *ad hoc* agreement was "*plainly not right*". It was held that the adjudicator's award was unenforceable.

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Fees

This leads to the question of whether an adjudicator is entitled to their fees where they have produced an unenforceable award. This is the issue that was considered recently by the Court of Appeal in the important case of *PC Harrington Contractors Ltd v Systech International Ltd* [2012] EWHC Civ 1371.

A dispute between a subcontractor and its own subcontractor was referred to adjudication. It was later held that the decision was unenforceable on the grounds that the adjudicator had breached the rules of natural justice. Systech, the adjudicator's employer, commenced proceedings against PCH to recover the adjudicator's outstanding fees.

The Court of Appeal overturned the High Court decision and held that the adjudicator was not entitled to the fees. It considered the terms of the contract and the provisions of the Scheme for Construction Contracts (England and Wales) Regulations 1998, and determined that the parties' bargain with the adjudicator was for an enforceable decision. It also concluded that paragraphs 8, 9 and 11 of the Scheme clearly showed that Parliament had not intended for an adjudicator to be paid in cases where they did not perform all of their obligations (including making an enforceable decision).

In particular, paragraph 11(2) provides that an adjudicator is not entitled to payment if their appointment is revoked as a result of "default or misconduct". The court considered that a breach of the rules of natural justice by the adjudicator constituted a 'default' or 'misconduct' and that it was "*a serious failure to conduct the adjudication in a lawful manner*".

The Court of Appeal also looked at policy considerations behind adjudication, concluding that the statutory provisions reflected a Parliamentary intention to provide a Scheme for a rough and ready temporary resolution of construction industry disputes. This is why the courts will enforce decisions that are shown to be wrong on the facts or in law. An erroneous decision was nevertheless an enforceable decision within the meaning of HGCRA and the Scheme.

However, a decision that was unenforceable through lack of jurisdiction or breach of the rules of natural justice was quite another matter. The Court of Appeal said its judgement should not have any great ramifications: adjudicators can simply incorporate into their terms of engagement a provision covering the payment of fees and expenses if a decision is not delivered or is unenforceable. Whether the court is correct remains to be seen.

Set-off

In July 2012, two judgements considered the issue of set-off. The first was *Squibb Group Ltd v Vertase FLI Ltd* [2012] EWHC 1958 (TCC). Here, the adjudicator had awarded Squibb, the subcontractor, an extension of time and £167,500 costs arising from the delay. He also decided that Vertase had not served any withholding notice for any cross-claim for liquidated and ascertained damages (LADs) and so was not entitled to deduct LADs from the adjudicator's award.

Vertase refused to pay the award, instead serving a withholding notice for £276,000 comprising:

- £105,000 LADs for the delay for which the adjudicator had not awarded an extension of time
- £171,000 for a number of other items that related to an alleged failure by Squibb to carry out work.

Squibb sought to enforce the award that Vertase resisted on the basis that it was entitled to serve and rely on its withholding notice. The judge determined that Vertase was not able to set-off its LAD claim against the adjudicator's award. The general rule is that the right to make such set-off is generally excluded; anything else would be contrary to HGCRA. However, there are two exceptions to the general rule:

- where there is a contractual right to set-off
- where the nature of the adjudicator's decision amounts to a declaration as to the proper operation of the contract.

The court decided that the situation did not fall within the exceptions to the general rule. In addition, the items had not been advanced during the adjudication. Vertase was not prevented from claiming the items in a separate adjudication, but it should not prevent the payment of the adjudicator's award.

Two days later, the court issued its judgement in *Beck Interiors Ltd v Classic Decorative Finishing Ltd* [2012] EWHC 1956 (TCC), which again considered the issue of set-off. At adjudication, Beck had been awarded £36,000 plus VAT. CDF, the subcontractor, refused to pay, arguing that it had a cross-claim arising out of a contract between the parties for a project in Dublin. The judge applied the same principles as in *Squibb.*

The starting point is that the court will rarely allow an unsuccessful party to set-off other separate claims against the adjudication award. Considering the two exceptions to the general rule, the judge concluded that:

- there was no express contractual right to set-off
- the adjudicator had clearly ordered immediate payment.

In no sense was his award a declaration as to how the contract should be interpreted. As to CDF's rights to equitable set-off, case law stresses that this will only be permitted where the cross-claim is so closely connected with the claim that it would be manifestly unjust to allow the claim without taking into account the cross-claim. However, in this instance there was no connection between Beck's claim and CDF's cross-claim other than the existence of two contracts between the same two parties. They were different contracts, concerned with entirely different works, in two separate countries (and therefore two separate jurisdictions). Accordingly, the judge rejected CDF's arguments of set-off and enforced the decision.

It seems that it is very difficult to set off amounts against an adjudicator's decision; so the rubric is "pay up". However, a successful challenge to an adjudicator's jurisdiction will not only avoid paying any amount in the decision but will also avoid the need to pay the adjudicator.

The court will rarely allow an unsuccessful party to set-off other separate claims against the adjudication award

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