WATSON FARLEY
&
WILLIAMS

BRIEFING

SMASH AND GRAB ADJUDICATIONS: A PATHWAY THROUGH THE THICKET

NOVEMBER 2018

- UK COURT OF APPEAL HERALDS AN END TO SMASH AND GRAB ADJUDICATIONS
- EMPLOYER CAN BRING AN ADJUDICATION TO DETERMINE TRUE VALUE OF INTERIM APPLICATION AFTER THEIR PAYMENT NOTICE OR PAY LESS NOTICE HAS BEEN FOUND DEFICIENT
- BUT EMPLOYER WILL HAVE TO PAY NOTIFIED SUM FIRST

In a significant decision for the construction industry, the UK Court of Appeal has held that, in circumstances where an employer's payment notice or pay less notice is deficient or non-existent, the employer remains entitled to commence a separate adjudication to determine the true value of an interim application, provided that it does so after it has paid the notified sum. In doing so, a happy medium has been found between maintaining a contractor's cash-flow throughout the duration of the project, and an employer's ability to later redress any overpayments made.

"THE COURT OF APPEAL'S CONFIRMATION OF THE FIRST INSTANCE DECISION SHOULD BE WELCOMED BY BOTH CONTRACTORS AND EMPLOYERS."

The decisions at first instance and in the Court of Appeal in *S&T (UK) Ltd v Grove Developments Ltd*[1] were both delivered by heavyweights of the construction industry and so merit particular respect. The first instance judge was Mr Justice Coulson, now himself on the Court of Appeal. Meanwhile former Technology and Construction Court mainstay and Court of Appeal judge, Sir Rupert Jackson (who retired at the beginning of March 2017), was invited back to deliver the leading judgment in the Court of Appeal.

The Court of Appeal's confirmation of the first instance decision should be welcomed by both contractors and employers, as well as others in the construction industry who have seen the reputation of adjudication as a dispute resolution mechanism undermined by opportunistic contractors seeking to take advantage of very large payment applications at the last interim stage.

[1] [2018] EWHC 123 (TCC) and [2018] EWCA Civ 2448. See also our Briefing Note of April 2018 in respect of the decision at first instance.

"THE IMPLICATIONS CAN BE VERY SERIOUS FOR AN EMPLOYER, PARTICULARLY TOWARDS THE END OF A PROJECT, WHERE THERE MAY BE LITTLE OR NO OPPORTUNITY FOR THEM TO CORRECT THE OVERPAYMENT AT THE NEXT INTERIM STAGE."

"Smash and grab"

The proliferation of "smash and grab" tactics since *ISG Construction Ltd v Seevic College*[2] means that many in the construction industry will not require any further explanation.

For those fortunate to be uninitiated, "smash and grab" occurs where a contractor unexpectedly submits a very large interim or final interim payment application and the employer fails to submit a valid payment notice and/or thereafter fails to submit a valid pay less notice. In such circumstances, the contractor's application can (subject to the particular contract) become a 'default payment' notice which entitles the contractor to payment of the sum applied for by the contractual final date for payment.

The implications can be very serious for an employer, particularly towards the end of a project, where there may be little or no opportunity for them to correct the overpayment at the next interim stage (because there isn't one), or where subsequent payments are less than the sum paid out to the contractor pursuant to its 'default payment' notice.

Where the validity of an employer's pay less notice is adjudicated in favour of the contractor, Mr Justice Edwards-Stuart's decision in *ISG v Seevic* meant that the employer is then prevented from commencing a further adjudication challenging the valuation of the contractor's interim application. As a consequence, employers could be left waiting months or even years before they could seek redress under the final account or by way of costly TCC proceedings.

As Mr Justice Coulson pointed out in his judgment at first instance in *S&T v Grove*, the effect of *ISG v Seevic* was that "…at the very time when the cases show that the right to adjudicate as to the 'true' value is most needed, it will not be available".

Brief facts

The parties entered into a JCT Design and Build 2011 contract for the construction of a new Premier Inn Hotel at Heathrow Terminal 4. The contract sum was around £26m with completion due 10 October 2016, although the project was not in fact completed until 24 March 2017.

Ironically, *Grove Developments* was not a tale of "smash and grab", but the facts gave rise to the same effect. The contractor, S&T, did not submit an unexpected increase in their interim notice, as in reality the divergence between the parties' valuations had been present for months. However, as events transpired, S&T's last interim application showed that they valued the contract at nearly £40m instead of the original £26m figure. S&T's final interim application, arriving after practical completion but far in advance of any final account determination, looked very much like the classic "smash and grab". The employer, Grove, issued a separate payment notice, but accepted this was out of time. It also submitted a pay less notice that was in time, but S&T argued it was defective and an adjudication on the point found in S&T's favour.

[2] [2014] EWHC 4007 (TCC)

In line with *ISG v Seevic*, Grove could not therefore bring an adjudication on the "true value" of S&T's interim application, so commenced court proceedings.

The Court of Appeal verdict

At first instance, Mr Justice Coulson was highly cognisant of the significance of his judgment to the construction industry, concluding that:

> "...I do not consider that the conclusions which I have reached strike at the heart of the adjudication system. On the contrary, I believe that it will strengthen the system, because it will reduce the number of 'smash and grab' claims which, in my view, have brought adjudication into a certain amount of disrepute."

Sir Rupert Jackson commenced his judgment in a similar vein, noting that the issue of whether an employer was entitled to adjudicate as to the value of an interim payment notice was "...of great importance to the construction industry."

He conducted a rigorous analysis of the conflicting authorities of the lower courts and was at pains to point out that, although his findings ultimately mean that *ISG v Seevic, Galliford Try*[3] and *Kersfield*[4], have been reversed on the issue of secondary valuation adjudications, this was in no way a criticism of the judges in those cases:

> "We are all trying to hack out a pathway through a dense thicket of amended legislation, burgeoning case law and ever-changing standard form contracts."

Those in the construction industry will have some sympathy with Sir Rupert Jackson's eloquently stated sentiments.

"SIR RUPERT JACKSON NOTED THAT WHEN THE INTERIM APPLICATION BECOMES PAYABLE IT DOES NOT MEAN THAT THE TRUE VALUE OF THE WORK IS ALSO THEN CONCLUSIVELY ESTABLISHED."

The Court of Appeal agreed with all the reasons provided by Mr Justice Coulson as to why an employer is entitled to open up the question of the valuation of an interim application after an adjudicator has found that it is payable. Sir Rupert Jackson noted that when the interim application becomes payable it does not mean that the true value of the work is also then conclusively established, emphasising the distinction between an obligation to pay a notified sum under section 111 of the Housing Grants, Construction and Regeneration Act 1996 (as amended by the Local Democracy, Economic Development and Construction Act 2009) (the "Amended Act") and a true valuation of the work done:

> "… section 111 is not the philosopher's stone. It does not transmute the sum notified by one or other of those three documents into a true valuation of the work done..."

Similarly, he found resonance in the distinction between the language in the JCT contract as to the "sum due" versus the "sum stated as due", indicating that the "sum *stated* as due" clearly leaves open the possibility for later review.

Force was found in S&T's argument that as an employer gets two bites of the cherry to advance its own valuation (via the payment notice and then the pay less notice)

[3] *Galliford Try Building Ltd v Estura Ltd* [2015] EWHC 412 (TCC)
[4] *Kersfield Developments (Bridge Road Ltd) v Bray & Slaughter Ltd* [2017] EWHC 15 (TCC)

there is little justification for providing further recourse through adjudication. However, although Sir Rupert Jackson was sympathetic, he noted that the time frames provided by contractual/statutory payment regimes do not lend themselves to complex and comprehensive valuations.

Most interestingly, counsel for S&T attacked the validity of Mr Justice Coulson's judgment by arguing that there was no juridical basis to establish that an employer would have to pay the sum set out in the interim application before commencing a "true value" adjudication. Seemingly, this was a finding favourable to contractors but S&T's counsel pointed out that there was nothing to prevent an employer simply refusing to pay and sitting on its hands until the outcome of the "true valuation" adjudication 28 days later. Enforcement of an adjudicator's award in favour of the contractor (in the amount of the interim payment notice) would not be able to take place within that timeframe, by which point the employer could point to the re-evaluated sum in the latest adjudication.

Sir Rupert Jackson dealt with this argument by reference to the Amended Act. He noted that the legislation clearly created a hierarchy of obligations, payment coming before adjudication, and that no sensible interpretation would permit the adjudication regime to trump the payment regime. This is consistent with the "pay now, argue later" ethos of adjudication which has been consistently endorsed by the courts.

"THIS WELCOME CONFIRMATION FROM THE COURT OF APPEAL IS SLIGHTLY TEMPERED BY THE PRACTICALITIES THAT THOSE IN THE INDUSTRY FACE."

Final considerations

This welcome confirmation from the Court of Appeal is slightly tempered by the practicalities that those in the industry face. In his judgment Sir Rupert Jackson found that an employer would have to pay before commencing a "true value" adjudication, even where it suspects that the contractor is at risk of insolvency. Practitioners would be right to be wary in such circumstances, where it is suggested a timely pay less notice is the most prudent course of action. A further concern arises in the context of supervising an employer's obligation to make prior payment where an adjudicator cannot order interim payment (unlike the courts).

Nevertheless, despite some concerns, the overall prognosis for the industry (particularly under the JCT regime) is improved by the Court of Appeal's decision and by the approach of Mr Justice Coulson that it upholds. It also addresses the reputational damage caused to adjudication by the post-*ISG v Seevic* "smash and grab" era.

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this briefing, please speak with the authors below or your regular contact at Watson Farley & Williams.

ROB FIDOE
Partner
London

+44 20 7863 8919
rfidoe@wfw.com

REBECCA WILLIAMS
Partner
London

+44 20 3036 9805
rwilliams@wfw.com

SAM PRENTKI
Senior Associate
London

+44 20 7814 8236
sprentki@wfw.com

Publication code number: Europe\63204446v1© Watson Farley & Williams 2018

All references to 'Watson Farley & Williams', 'WFW' and 'the firm' in this document mean Watson Farley & Williams LLP and/or its Affiliated Entities. Any reference to a 'partner' means a member of Watson Farley & Williams LLP, or a member or partner in an Affiliated Entity, or an employee or consultant with equivalent standing and qualification. The transactions and matters referred to in this document represent the experience of our lawyers. This publication is produced by Watson Farley & Williams. It provides a summary of the legal issues, but is not intended to give specific legal advice. The situation described may not apply to your circumstances. If you require advice or have questions or comments on its subject, please speak to your usual contact at Watson Farley & Williams.
This publication constitutes attorney advertising.