The End of 'Smash and Grab' Adjudications?

Grove Developments Limited v S&T (UK) Limited [2018] EWHC 123 (TCC)

In a significant decision, Mr Justice Coulson has held that, contrary to the decision in ISG v Seevic, an employer is entitled to run a second adjudication to determine the 'true' value of an interim application for payment, even if the employer's payment notice and payless notice were invalid. This decision could therefore sound the death knell for the 'smash and grab' adjudications which have become prevalent in recent years.

Anthony Speaight QC and Matthew Thorne represented the contractor.

Background

By a JCT Design & Build Contract 2011, Grove engaged S&T to design and build a new Premier Inn Hotel at Heathrow Terminal 4. In the course of the project, disputes arose about the sum due under an interim application for payment and about Grove's levying of liquidated damages. There were three adjudications between the parties. In the third, the adjudicator decided that Grove's payless notice was invalid, which meant that S&T was, on the face of it, entitled to be paid £14m under its interim application.

The following issues came before Mr Justice Coulson in a combined Part 8 hearing:

(a) Issue A: whether Grove's payless notice complied with the requirements of the contract;
(b) Issue B: whether, if the payless notice did comply, the result in the third adjudication should be enforced;
(c) Issue C: whether Grove is entitled to commence a separate adjudication seeking a decision as to the 'true' value of the interim application; and
(d) Issue D: separately, whether Grove's notices in respect of liquidated damages were properly issued.

Issues A and B: How should the basis of calculation be "specified"?

The first issue before the Court was whether Grove's payless notice complied with the requirement of the contract that payment notices "specify the basis of calculation" of the sum stated to be due.

It was common ground that Grove's Payment Notice was out of time and invalid. Grove therefore relied on its Payless Notice. The Payless Notice specified the sum stated to be due, but did not set out the basis of calculation. Instead, it referred back to the calculation set out in detail in its earlier (invalid) Payment Notice.

S&T said this was not good enough: the notice must expressly set out the basis of calculation on the face of that notice.

Coulson J disagreed. He held that the basis of calculation could be incorporated by reference, because a "payless notice will be construed by reference to its background, in order to see how a reasonable recipient would have understood it". It will be a matter of fact and degree whether the notice was valid. Rejecting S&T's definition of 'specify', he held that "'specify' goes to the detail required in the Notice, not the method by which that detail was conveyed to the other party".

Coulson J therefore found that Grove's payless notice was valid (Issue A) and that the decision in the third adjudication should not be enforced (Issue B).

The decision on this point could lead to an increase in factual disputes as to whether the contractually required information was properly incorporated by reference. There was, however, some comfort for contractors, Coulson J holding that he did "not consider that the courts should generally adopt a different approach to the construction of the two kinds of notices" (i.e. those issued by contractors and those issued by employers). Therefore an employer's payless notice should not ordinarily be construed more generously than the contractor's application or notice.

Issue C: The 'true' value of the sum due

This part of Coulson J's decision has significant implications for the construction industry. Since at least the decision of Edwards-Stuart J in ISG v Seevic [2014] EWHC 4007, the TCC has consistently held that, in respect of the JCT D&B 2011 (and similar forms), the sum to be paid by the employer was the sum "stated as due" in the relevant Notice; and, if the employer failed to issue a valid Payment Notice or Payless Notice, it would be bound to pay the sum stated in the contractor's interim application for payment (for example, in Galliford Try v Estura [2015] EWHC 412, Kilker v Purton [2016] EWHC 2616 and Kersfield v Bray [2017] EWHC 15).

Whilst Fraser J had expressed some reservations about this in ICI v Merrit [2017] EWHC 1763, the law in this area had been understood by most in the industry and legal profession to be well established.

In a significant departure from the previous authorities, Coulson J held that an employer is entitled to commence an adjudication to determine the 'true' value of the interim account, even if it failed to issue a valid Payment Notice or Payless Notice.

In this lengthy decision, Coulson J went back to "first principles" and reviewed the case-law in detail. He decided that:

"An employer who has failed to serve its own payment notice or payless notice has to pay the amount claimed by the contractor because that is 'the sum stated as due'. But the employer is then free to commence its own adjudication proceedings in which the dispute as to the 'true' value of the application can be determined".

Coulson J gave six reasons for his decision, as follows:

(1) Referring to Henry Boot [2005] 1 WLR 3850 and Beaufort v Gilbert Ash [1999] 1 AC 266, he noted that it had always been open to the Court to open up, review, and revise certificates issued by the architect. He held that there was "no essential difference" between these certificates and the payment notices in the modern forms of contract. Accordingly, the Courts (and thus adjudicators) could decide the 'true' value of an interim application for payment.

(2) Section 108(1) of the 1996 Act permits a party to refer "a dispute arising under the contract for adjudication". Likewise, paragraph 20 of the Scheme provides that the adjudicator "shall decide the matters in dispute". Coulson J therefore concluded that there was "no limitation on the nature, scope and extent of the dispute which either side can refer to an adjudicator" and "no limit on the power or jurisdiction of an adjudicator which would prevent him or her" from deciding a subsequent dispute as to the 'true' valuation.

(3) A dispute about valuation is different from a dispute about the sum stated in a Notice. The true valuation was therefore not considered or decided in an earlier adjudication about notice.

(4) The words of the contract distinguish between "the sum due" (clause 4.7.2) and "the sum stated as due" (clause 4.9). Coulson J considered the former to be designed "to calculate the contractor's precise entitlement" whilst the latter regulates payment due to failure to serve a valid Payless Notice. The latter did not, he held, transform into the former and, having paid "the sum stated as due", the employer was entitled to commence an adjudication as to the 'true' valuation of "the sum due".

(5) Coulson J invoked "equality and fairness" in balancing the employer's ability to commence a valuation adjudication with the uncontroversial ability for a contractor to do so, as envisaged by sections 111(8) and (9) of the 1996 Act.

(6) Finally, Coulson J did not accept there was a distinction in the JCT form between interim and final payments, and there was nothing to justify their different treatment in terms of obtaining a 'true' valuation.

This decision is likely to send shockwaves through the industry. The practice of so-called 'smash and grab' adjudications has become widespread in recent years. Coulson J's lengthy decision appears to be designed to reduce this practice. It is likely to lead to an increase in employers, who have failed to serve valid notices, commencing valuation adjudications instead of paying the sum "stated as due" in the contractor's application.

This judgment also confirms that the contractual payment regime is intended to determine the parties' rights only on an interim basis, leaving it open for both parties to open up the relevant notices and applications at a later date.

Issue D: Timing of notices for Liquidated Damages

The final issue examined by Coulson J is unconnected to the payment regime, but raises an important point about notices relating to liquidated damages.

By clause 2.29 of the JCT form, an employer is required to take three steps before it can deduct liquidated damages:

(a) First, the issue of a non-completion notice.
(b) Second, the issue of a notice that the employer "may require payment of, or may withhold or deduct, liquidated damages". This was labelled a Warning Notice.
(c) Third, a Notice that the employer "requires" the contractor to pay liquidated damages or "will" withhold or deduct liquidated damages. This was labelled a Deduction Notice.

Grove sent the Warning Notice and Deduction Notice in the correct sequence, but in such quick succession that the former had not reached S&T's inbox before the latter was sent.

S&T contended that the Deduction Notice was invalid, because it had not received the Warning Notice before the Deduction Notice was sent, and so it had not been given time to read or digest the Warning Notice first.

Coulson J rejected that argument, holding that:

"*The contract required two separate notices and it required those notices to be sent, and received, in a particular sequence. If one or both of those notices was not received, or if they had been sent or received in the wrong order, they would be prima facie invalid. But that is not the case…*
"…I have come to the conclusion that, provided – as here – the two sets of notices were served in the correct sequence and were received in the correct sequence, they cannot be said to be defective."

This is a notable determination because it makes the Warning Notice a mere procedural hurdle. If there is no requirement for any time to elapse between the issue of the Warning Notice and the issue of the Deduction Notice, then this raises questions about the purpose and utility of the Warning Notice.

Conclusion

This decision, one of Mr Justice Coulson's final judgments before his elevation to the Court of Appeal, is likely to send some shockwaves around the construction industry, which has become used to the phenomenon of so-called 'smash and grab' adjudications.

This decision may well spell the end of such practice, at least for now. Coulson J gave S&T permission to appeal against his decision on Issues A, C and D. It will be interesting to see how the Court of Appeal will approach these important issues, which continue to exercise the industry.