Ground-breaking test case on the new payment regime: No second adjudication on value

***ISG Construction Ltd v Seevic College* [2014] EWHC 4007 (TCC)**

Mr Justice Edwards-Stuart has introduced greater clarity to the new payment regime introduced by the Local Democracy, Economic Development and Construction Act 2009 in this ground-breaking test case. Alexander Hickey represented the successful Claimant.

Context: the new payment regime

It has been several years since the 2011 amendments to the Housing Grants Construction & Regeneration Act 1996 replaced the withholding notice regime with a payment notice/payless notice regime. The new regime introduced the concept that the "notified sum" was to be paid, rather than the old system of "amount due". That previous regime gave rise to uncertainty about how to deal with abatement, and proper value in cases such as *SL Timber Systems Ltd v Carillion Construction Ltd* [2001] 1 BLR 516 (Scotland), or the impasse situation where a contract provides for payments against certificates but no certificate was issued against a contractor's payment application. Even after *Rupert Morgan Building Services (LLC) Limited v Jervis* [2003] EWCA Civ 1563 there was considered to be a need for a clearer system.

The Courts had not had occasion to rule upon the new regime. Instead, in recent years the Court's attention has mainly been focused on the latest trend of arguments about whether one adjudication decision may be set-off against another: that has presented a bewildering number of authorities.

The absence of judicial authority on how the new payment regime works and the focus on set-offs has presented fertile ground for the growth, down at the adjudication level, of a worrying trend in payment disputes. There have been murmurs from some in the industry who thought it high time this was sorted out by the Court. The problem comes about whenever the payment notice regime appears to allow a party to get paid more than the other party considers he is entitled to claim, without having to prove the amount claimed: in other words a 'smash and grab win on a technicality'. Typically what happens is that a party faced with a payment notice/payless notice adjudication argues that there is a separate adjudicable dispute about the true 'value' of the works which is different from the amount to

be paid against the payment notice (or payless notice). Sometimes the adjudicator indicates that he is simply applying the notice regime and is not deciding the proper value of the works. There is often the sense of a tacit understanding between the adjudicator and losing party that if only the merits were to be investigated a different amount might be due. What then follows is the losing party starts a second adjudication directed to the merits about the value of the claim, which results in a decision for a different amount and/or a claim for repayment. That party then seeks to set this off against the payment notice decision.

The facts

This is what happened in the present case. ISG, a design and build contractor on JCT DB 2011 terms made an interim payment application no. 13 (IC13) after practical completion but before the final account. ISG claimed just over £1million. It included some claims one might expect in a final account, such as loss and expense.

The Employer, Seevic College, did not give a payment notice. The College was late in giving a payless notice, so it was ineffective. ISG commenced an adjudication seeking payment against IC13 as the default payment notice. The College first argued that its payless notice was in time, but in any event sought, and obtained, the adjudicator's ruling in Adjudication 1 that he was not deciding the value of the works as at the date of IC13. The adjudicator, his hands tied, ordered payment of the amount claimed by ISG.

Anticipating its defeat, the College commenced a new adjudication, Adjudication 2 on the value of the works as at the time of IC13. The College asked the adjudicator to order the difference between the value and the decision in Adjudication 1 to be repaid to the College. The same adjudicator was appointed. He was invited but refused to resign, saying it was not clear that he had no jurisdiction over a (different) dispute about 'value'. This time, he valued the works and concluded that the amount due as at the time of IC13 was only just over £315,000. On the assumption that the College had complied with the first decision, he ordered repayment by ISG of the difference.

The College had in fact refused to pay against the decision in Adjudication 1. It maintained that it could and would set-off the decision in Adjudication 2. The College sent ISG a cheque for a smaller amount, equivalent to the amount decided in Adjudication 2.

ISG brought proceedings to enforce the decision in Adjudication 1 and for declarations that Adjudication 2 was void and the adjudicator should have resigned. ISG argued that Adjudication 2 was the same or substantially the same dispute and there was no dispute capable of being adjudicated in Adjudication 2 because it was necessarily part of the dispute that was decided in Adjudication 1.

The Judgment

In a clear ruling the Judge in Charge of the TCC, Edwards-Stuart J, has made it clear that the sort of situation described above will not be allowed to happen again. He enforced the decision in Adjudication 1 and ruled that Adjudication 2 was void and that the College was not entitled to seek to dispute the payment entitlement by attacking the value of the works outside of the notice regime.

In summary, Edwards-Stuart J held as follows:

- Properly analysed, the contractor's only entitlement to payment is either through the machinery for interim applications or, at the end of the project, following issue of the Final Statement. He has no other entitlement to payment under the contract. He is to be paid the 'notified' sum. The contractor has no entitlement to be paid the value of his work during the course of the contract.
- Equally important, the employer must follow the payment notice regime carefully if it wishes to dispute the value of the works done to date and the amount applied for. Another way of putting this is to say that, as between contractor and employer, in the absence of any notices the amount stated in the contractor's application as the value of the works executed is deemed to be the value of those works so that the employer must pay the sum applied for.
- If the employer has not complied with the notice provisions the employer has no right to seek a repayment of money paid to the contractor on the ground that either at the date of the last interim application or some subsequent date, the true value of the contractor's work was less than the gross amount stated in that application. The employer is not entitled to demand a valuation of the contractor's work on any other date than the valuation dates for interim applications or any financial award as a consequence of it.
- If the employer fails to serve any notices in time it must be taken to be agreeing the value stated in the application, right or wrong. (It is suggested that this does not mean for all time in the context of the final account).

Edwards-Stuart J held that, in the present case, the first adjudicator must be in principle taken to have decided the question of the value of the work carried out by the contractor for the purposes of the interim application in question.

The Judge went on to say at [47] and [48] that the statutory regime would be completely undermined if an employer, having failed to issue the necessary payment or pay less notice, could refer to adjudication the question of the value of the contractor's work at the time of the interim application (or some later date) and then seek a decision requiring either a payment to the contractor or a repayment by the contractor based on the difference between the value of the work as determined by the

adjudicator and the sums already paid under the contract. If this were permissible, any such decision by an adjudicator would trump the contractor's interim application because the contractor would then be entitled to an amount representing the value of the work properly executed, as determined by the adjudicator, less the sums already paid.

Finally, at [52] Edwards-Stuart J reiterated the contractual position:

'*Absent fraud, in the absence of a payment or pay less notice issued in time by the employer, the contractor becomes entitled to the amount stated in the interim application irrespective of the true value of the work actually carried out. The employer can defend itself by serving the notices provided for by the contractual provisions*.'

This is welcome news for contractors. Employers need to pay very close attention to payment applications if they want to preserve their rights to argue for a different amount.

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