Security of Payment and Adjudication: A UK Perspective

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1 INTRODUCTION

1.1 On May 1, 1998, Part II of the Housing Grants Construction & Regeneration Act 1996 (the UK Act) came into force. Despite its deceptive title, it was this Act which ushered in a new era of compulsory security of payment, and adjudication, within the UK construction industry. It is this Act upon which both the New South Wales and Victorian Security of Payment Acts are based.

1.2 The aim of this paper is to give a brief overview of the UK construction industry's experiences following introduction of the UK Act. The purpose of such a review is to provide some insight into what the Victorian construction industry might expect following the introduction of the Building and Construction Industry Security of Payment Act 2002 (the Vic. Act). The Vic. Act will come into force on 31 January 2003.

2 DIFFERENCES AND SIMILARITIES BETWEEN THE UK AND VIC. ACTS

Differences

2.1 Perhaps the most obvious difference between the UK Act and the Vic. Act relates to the enforcement of an adjudicator's decision.

2.2 Under the UK Act, the decision of an adjudicator is binding on the parties, until such time as the decision is reversed in an arbitration or litigation. Accordingly, if the adjudication involved a claim for a progress payment, a decision in favour of the claimant will require the respondent to immediately pay the amount determined. The claimant can enter judgement against the respondent for the amount of the decision and commence recovery proceedings in the same way as one would a judgement debt.

2.3 This places immediate commercial pressures on the respondent in that, if it fails in the adjudication, it will then have to fight to recover the monies paid. There is an obvious advantage to a subcontractor to have the benefit of this cash flow. There is a further disadvantage to a contractor in that if the subcontractor subsequently becomes insolvent, it may not be possible or cost effective to recover the sums in subsequent arbitration or litigation.

2.4 Under the Vic. Act, the adjudication process is intended to provide a mechanism for determining a reasonable amount for the claim and give a means of securing that amount until such time as the matter has been properly and finally determined. It does not create an automatic right to enter judgement for the determined sum. If an adjudicator has decided that a claimant is entitled to payment, the respondent can either pay that amount, or alternatively, commence dispute resolution proceedings either in relation to the dispute, or include it with other disputes already on foot, and just provide security for the amount determined by the adjudicator. The form of security may take that of a written unconditional undertaking by a recognised financial institution to pay the amount on demand, or the payment of the amount into a designated trust fund, or other form of security agreed by the parties.

2.5 This is an important distinction between the two Acts, as it changes the commercial balance of power. Whilst the Vic. Act provides for a process whereby a party can obtain security for a sum due, if the respondent so chooses, the claimant will still have to fight through arbitration or litigation to finally obtain the funds. Whilst there may be cost consequences in any subsequent arbitration or litigation for a respondent who adopts a particularly bullish approach to non payment of an adjudicator's award, such an approach will invariably place commercial pressure on the claimant in the context of any potential settlement negotiations.

2.6 The UK Act applies to construction contracts for "the carrying out of construction operations or the provision of advice in relation to construction operations". However, the Vic. Act applies not only to these types of contracts, but also to those for the supply of goods related to construction work including:

(a) Materials and components to form part of any building, structure or work arising from construction work; and

(b) Plant or materials (whether supplied by sale, hire or otherwise) for use in connection with the carrying out of construction work.

Accordingly, the Vic. Act will potentially apply to a wider suite of contracts and creates a potential entitlement to payment not only for service providers, but also for material suppliers.

2.7 The UK Act applies to agreements in writing, although the definition is very broad. By contrast, the Vic. Act applies to oral agreements as well as written agreements.

2.8 Under the UK Act, all contract disputes can be referred to an adjudicator. However only disputed progress payment claims are covered by the Vic. Act. Accordingly, the adjudicator has much more limited powers under the Vic. Act than those under the UK Act.

2.9 The UK Act prescribes a 28 day (or 42 days by agreement of the parties) period within which the adjudicator is required to provide his decision. By contrast, the Vic. Act only allows an adjudicator 10 business days to decide the claim, unless this period is extended by agreement between the parties. This will make for a very rapid process, with all the consequent implications that such a truncated period will have for a respondent party to get on top of and adequately respond to the claims made.

2.10 The Vic. Act allows a claimant who has a favourable adjudication decision enforced by the Court, to serve a Notice of Assignment on the principal of the project. Thus any sums owed by the principal to the respondent, become payable directly to the claimant, until such time as the debt of the respondent is discharged. The UK Act makes no such provisions.

2.11 Finally, the UK Act requires seven days notice of suspension by a claimant, whereas the Vic. Act only requires two days notice.

Similarities

2.12 Given that the Victorian and New South Wales Security of Payment Acts have their genesis in the UK Legislation, it is not surprising that there are considerable similarities between them. The primary similarities between the two include the following:

(a) A desire by the legislature to enshrine in statute an entitlement to payment for work done, and to provide a means of rapidly securing an enforceable entitlement to payment.

(b) A speedy and relatively simple process of adjudication.

(c) Strict mandatory time limits for the initiation, conduct and finalisation of the adjudication process.

(d) Binding interim adjudication decisions which secure payment, unless and until overturned by adjudication or litigation.

(e) Limited rights of appeal from the adjudication process.

(f) Statutory disallowance of pay when paid clauses.

(g) The central pillar of adjudication as the mechanism for resolving disputes and obtaining security of payment.

2.13 Thus it can be seen that the Vic. Act is broadly in line with the UK Act, particularly with respect to the conduct and effect of adjudications. As such, the UK experience of adjudications in the construction industry should provide a useful prophecy of what might be expected to occur in the Victorian construction industry, following the introduction of the Vic. Act in January of 2003.

3 WHO IS USING ADJUDICATION?

3.1 In a recent report on the findings of a study into adjudication undertaken by the Glasgow Caledonian University, numerous findings were set out in relation to the adjudication process. It was clear from the results of the study that the principal parties to adjudication were main contractors and their domestic subcontractors. For the period from May 2000 until October 2001, 48% of all adjudications were between main contractors and domestic subcontractors. This was followed by main contractors and their clients who comprised 31% of the adjudications for the same period.

3.2 The report noted with interest that the percentage breakdown of parties to adjudications has changed over the time the UK Act has been operating. The data

showed that, proportionately, the percentage of adjudication disputes between domestic subcontractors and main contractors was reducing, and that adjudication of disputes between other important contracting pairs was increasing. It showed that adjudications between client and nominated subcontractors had risen to 8%, subcontractor to subcontractor to 6% and clients to consultants to 4%.

3.3 The report concluded that there was a developing trend of other contracting parties who had initially been slow to accept adjudication as a means of resolving disputes, increasingly seeing adjudication as a powerful and effective weapon.

3.4 Given that the Victorian Legislation covers contracts governing the supply of goods and materials, it is fair to assume that if the UK trends are replicated in Victoria, suppliers of goods and materials will increasingly turn to adjudication to secure more rapid payment of outstanding sums.

3.5 The results of the Glasgow Caledonian University study are reflective of the experience at Masons where, up to September 2000, approximately 95% of all adjudications involved a claimant contractor or subcontractor.

4 UK INDUSTRY PERCEPTIONS: IS ADJUDICATION CONSIDERED FAIR, FAST, RELIABLE AND COST EFFECTIVE?

4.1 Masons recently undertook an industry wide survey in which the perception of the UK Construction Industry was assessed in four key areas. This survey was augmented with feedback from adjudications conducted by Masons, which now number well in excess of 100. The findings were as follows:

(a) Is the process fair?

The Masons survey showed that approximately 60% of participants believed that adjudication was indeed fair. It is perhaps not surprising that the view of the industry on this aspect is not higher, given that, in a broader sense, half the parties to an adjudication will lose, and may not exactly embrace the process and its outcome as particularly fair. Perhaps the more instructive result from the survey was that some 70% of participants were in favour of adjudication as a process.

(b) Is the process considered to be fast?

There was a resounding agreement within the industry that the process is rapid, with 90% agreeing that adjudication was a fast method of dealing with disputes. This is perhaps not surprising when considered against the backdrop of traditional dispute resolution processes such as arbitration and litigation, which ordinarily take months, if not years to complete.

As stated above, it should be noted that the process of adjudication provided for

under the Vic. Act is even more rapid than that set out by the UK Act.

(c) Is the process reliable?

Opinion on the reliability of adjudications was divided. Factors such as a concern over the quality of adjudicators and the limited time available for adjudicators to investigate claims, no doubt influenced industry views.

A further concern which may be held by the construction industry is that adjudicators are aware their awards may not be the final stage in the process of resolving the dispute, particularly given the speed with which they must come to a decision. There is a generally perceived fear that adjudicators may "play it safe" and give a modest award with the view that it can always be challenged in the future. The damage caused by making a full award to the wrong party cannot always be offset: a more modest award ensures that the party against whom it is levied will suffer less and injury is minimised. If adjudicators take a King Solomon style "cutting the baby in two" approach, it may simply entrench the parties' dispute and do no more than guarantee the addition of another layer of costs as the dispute moves towards a final resolution.

(d) Is the process considered to be cost effective?

Of those surveyed, 81% were of the opinion that adjudication is a cost effective forum. This is perhaps not surprising given the short time frame involved with adjudication, when compared to arbitration or litigation. The strict time limits associated with the process place a physical limitation on the amount of time that lawyers, accountants, experts and others can spend on preparing or presenting a party's position. There is often not the time to ensure that "no stone is left unturned", which can lead to unfortunate or unexpected conclusions.

5 ARE ADJUDICATORS DECISIONS BEING CHALLENGED?

5.1 There appears to have been a clear policy decision made by the UK Courts, to support the underlying intent of the legislature to create a fast, effective and interim binding process which speedily resolves disputes during the currency of a construction contract. To this end, whilst there have been over forty reported decisions following applications to Court to enforce/overturn adjudicators' decisions, very few of these have met with any success. The most common challenges are to the jurisdiction of the adjudicator or the correctness of the decision. It may be surmised that the Court has adopted the view that an adjudicator's decision is only of an interim nature and that there is generally a mechanism available through which the decision can be overturned by litigation or arbitration.

5.2 It was Masons' experience that in approximately 80% of cases, the adjudicator's award was accepted as the final determination on the matter.

5.3 This is encouraging, as on one view, adjudication can be seen as just another costly step in the longer journey towards resolution of disputes by arbitration or litigation.

6 ADJUDICATION ISSUES IDENTIFIED BY CLAIMANTS AND RESPONDENTS

6.1 There is now a body of experience which has been built up over the four years that the security for payment adjudication procedures have been effective in the UK. From this experience can be derived a number of benefits and pitfalls experienced by both claimants and respondents.

Claimants

6.2 Amongst those issues identified by claimants are the following:

- Some notices of adjudication fail to deal with all the issues in dispute. Some referring parties seek to introduce issues into the referral notice which are not included in the Notice of Adjudication.
- Some referral notices simply set out long explanations of what went wrong with the calculation of how much it cost, without any analysis of the issues raised and how the cost links to the breaches complained of. The referral notices often lack analysis and structure, and frequently make requests for an extension of time without dealing with criticality at all.
- The parties with intelligence on adjudications are able to capitalise on it by considering the adjudicator's views in relation to certain issues when presenting their cases. Ultimately specifying known adjudicators in a contract can assist.
- It is rare for a claimant party to be wholly unsuccessful. The responding party almost always ends up paying something. The problem is that a party may "try it on" even if the claim lacks merit.
- There is a problem with parties using adjudication for large and complex disputes which could only be covered properly in Court or arbitration. The outcome of such proceedings is unpredictable.
- One of the benefits of adjudication is that it can stimulate negotiations. The threat of going to adjudication can bring parties to the table and focus their minds.

Respondents

6.3 The following serves as a potted summary of some of the experiences common to respondents in UK adjudications:

- Respondents are often taken by surprise on receipt of the notices. Some have little in the way of procedures for managing the process and have to start collating base information for a response from scratch.
- Responding parties have difficulty in that there is often a great deal to be done in a very short space of time. There is a sense of ambush. Responding parties have to be prepared to drop everything else and focus on the adjudication. The time required is generally underestimated.
- The responding party is under pressure as the referring party is in control of the procedure and its time scale.

- Responding parties often fail to carry out a basic check on jurisdictional issues such as whether the works are caught by the Act, and whether the referral notice ties in with the issues and the Notice of Adjudication.
- Time scales are difficult but extensions of time can be agreed.

7 SOME EXPERIENCES OF UK ADJUDICATORS

- A review conducted by Masons of experienced adjudicators in the UK Construction Industry produced the following comments:
- Overall, adjudication works well, particularly in the sorts of disputes that it was meant for, i.e. the smaller, single issue dispute, such as interim payment disputes.
- Adjudicators were generally not impressed by masses of paper and were of the view that too many parties "bulk out" their submissions with irrelevant or unnecessary information. The more successful parties analyse their positions in detail to get at the real issues and reduce their arguments and keep documents to a minimum.
- Several adjudicators said that the referral should be restricted to the number of issues which an adjudicator could reasonably be expected to cover within the time scale. If a matter is particularly complex, the party should consider whether the matter is appropriate for adjudication.
- Adjudicators decisions are often constrained by the poor quality and confused presentation of information provided. Submissions should be clear, concise, and easy to follow and should only include what is relevant. Adjudicators waste time when they have to work out what the parties mean rather than deal with the issues. One mentioned that details concerning quantum are often not dealt with as thoroughly as they should be.
- Views varied on the concept of responding parties being high-jacked by referring parties who have had months in which to prepare referral notices. Some did not think it a problem at all. Others thought that the problem was not as prolific as perceived by some in the industry. Most indicated that they would give a responding party as much time as they could. Some said that disputes should be negotiated properly before they are referred to adjudication to reduce the possibility of ambush.
- One adjudicator recommended that jurisdictional issues are better thought through by the referring party before the Notice of Adjudication is given and that any dispute regarding jurisdiction should be dealt with at the outset of the procedure.
- Adjudicators usually take slightly longer than the 28 day period allowed with parties almost always agreeing extensions of time.

- It would be a good idea to put in the contract/agree to have a slip rule to ensure that there is no doubt that an adjudicator may correct a minor or clerical error in a decision. Some adjudicators were concerned at the quality of adjudicators and several expressed the hope that there would be some professional regulation in this regard.
- Adjudicators acknowledge that the speed of the process can lead to mistakes by all concerned.
- Nearly all adjudicators gave the impression that they wanted to be proactive in their approach and that they would use their licence to act inquisitorially in ascertaining the facts by having meetings with the parties at which the adjudicator would quiz the parties in detail about their cases.
- Finally, one adjudicator said that parties should be aware of embarrassing the adjudicator by addressing or dealing with them, without the other party being in attendance. Parties should make it patently clear all correspondence or documents sent to the adjudicator, have been copied to the other side.

8 SUMMARY

- In summary, the overall view of the UK construction industry appears to be one of general approval for the adjudication concept. There is a degree of concern held as to the ability of the process to reliably reach the right decision. Its advantages are seen to be its speed and cost, but it can be a largely fruitless exercise if the adjudicator does not properly grapple with the issues and just seeks refuge in the middle ground. However, there is a body of evidence to suggest that if the parties can adequately prepare and present their respective positions and the adjudication process is diligently discharged by the adjudicator, the majority of parties will accept the result without going on to challenge the decision in arbitration or litigation.
- The Vic. Act has considerable commonality with the UK Act and, in time, the Victorian Construction Industry can expect to reflect similar experiences to those outlined above. However, the lack of a requirement for an immediate cash payment to claimants may vary the manner in which the industry responds to the process and may lead to more "commercial" settlements between parties to facilitate cash flow and avoid drawn out and costly arbitration or litigation.