ARBITRATION – IS IT A REAL ALTERNATIVE?

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1. THE PROBLEMS OF ADJUDICATION

Before the introduction of adjudication, disputes were resolved in court or in arbitration. Both had a reputation for being expensive and slow (although if viewed from an international perspective UK litigation and domestic arbitration was really quite efficient). A 28 day process was a remarkable innovation. Because relatively little time was taken, the costs were normally relatively low. It works because it has been supported by the courts. It is hardly surprising that it has become the principal dispute resolution system for the UK construction industries.

A construction industry party contemplating taking formal steps to resolve a claim now automatically thinks adjudication. Often this will clearly be the right way to proceed, for example when there is a single issue in dispute, such as the valuation of a change or the deduction of a contra charge. There are times however when a claimant should consider a more traditional approach.

Let us consider some of the problems.

1.1 Cost

Final account disputes involving large numbers (perhaps thousands) of items, dozens of lever arch files of paper and expert opinions are not at all uncommon. The preparation of the claim will take several months, and the costs of preparation of the case will be very substantial. The adjudication that led to *CIB Properties Ltd v Birse Construction Ltd* [2004] EWHC 2365 was an example. Judge Toulmin gave us a clue as to how expensive it was:

"There is no doubt that the procedure is being used in disputes which are to be resolved long after the contract which is the subject matter of the dispute, has come to an end. It has come to be used, as in this case, as a form of intense confrontational litigation which can be very costly. I was told that CIB's costs of the two adjudications [the first being about whether the termination of the contract was in accordance with its terms] amounted to £973,732.412 and Birse's costs to £1,161,341.70, in each case excluding VAT. To this must be added the

Adjudicator's costs in the two adjudications. The Adjudicator's costs in the second adjudication amounted to £150,000. This could not be described as inexpensive."

In the absence of a *Tolent* clause, and in fact since the decision of Mr Justice Edwards-Stuart in *Yuanda (UK) Co Ltd v WW Gear Construction Ltd* [2010] EWHC 720 in April, both sides in the adjudication know that they are not going to recover any of their own legal costs. Adjudication was expected to be "relatively inexpensive" (Lord Ackner in the House of Lords debate).

Costs are not only a serious consideration in the multi million pound cases. The expense of the process can make adjudication unrealistic in small or medium sized cases as well.

1.2 Risk of error

We have known since the very early days of adjudication that the process can produce unreliable decisions that will nevertheless be enforceable. The famous case is of course *Bouygues UK Ltd v Dahl-Jensen UK Ltd* [2001] 1 All ER (Comm) 1041. Bouygues was saved from suffering serious consequences of an (alleged) error on the part of the adjudicator by the fact that Dahl-Jensen went into liquidation.

Adjudicators hope that their decisions are more or less right, but they know that in a final account type of case it is extremely unlikely that the decision will be more accurate than an approximation of the balance due to a party. It is possible that the decision will be wrong in a more fundamental way. The risk of error must be considered by even the most confident potential party.

It would be unreasonable to blame adjudicators for this. The full procedures of litigation and arbitration are there for a purpose. Disclosure enables each party to have some confidence that what was really going in the opposing organisation will be revealed. Contemporary paperwork enables witness testimony to be reality tested. Cross examination enables that testimony to be tested, sometimes to destruction.

Neither process is available in adjudication, and even with the most competent, intelligent and perceptive adjudicators the truth can remain well hidden.

1.3 Interest

There is no free-standing power for an adjudicator to award interest. This was established in the judgment of Lord Justice Chadwick in *Carillion Construction Ltd v Devonport Royal Dockyard* [EWCA] Civ 1358. There may be a contractual right to interest, and there may be a right under the Late Payment of Commercial Debts (Interest) Act 1998, but there is no power analogous to that of an arbitrator under section 49 of the Arbitration Act or section 35A of the Supreme Court Act 1981.

1.4 Limitation to one dispute and one contract

The courts have been fairly liberal in defining "one dispute" and whilst a final account claim encompassing dozens of disputed variations, several delaying events and cross claims for liquidated damages can be treated as one dispute, but it can get much more difficult when claims arise under a series of contracts between the parties.

1.5 Enforceability

There is no point in going through the adjudication exercise if the adjudicator's decision is not going to be enforceable. The principal challenges to enforcement are that the adjudicator acted outside his jurisdiction, in that there was no crystallised dispute in the first place or he answered the wrong question, or that there has been a breach of natural justice.

These are not generally considerations when deciding whether adjudication is the right procedure. The lack of a crystallised dispute is soon remedied. The question can be drafted with care and the adjudicator can be encouraged to stick to it. A breach of natural justice will not normally be foreseen.

There has however been a succession of judicial comment suggesting that there are some matters that really are not suitable for adjudication, and that whilst there may be a right to refer, the adjudicator can and in some circumstances should decline to proceed on the basis that there is insufficient opportunity within the process to deal fairly with the issued.

The chain of cases does not start with *CIB Properties Ltd v Birse Construction Ltd*, but that is the first case to be mentioned today. This was a very substantial adjudication. The claim

was for £14.5million. The adjudicator made it very clear at the start that he would need more time than the basic 28 days. In fact there were several extensions so that the period from referral to decision was about 3 months.

It was alleged by Birse that the size and complexity of the dispute meant that it could not be resolved fairly by adjudication. There were some 148 lever arch files of material submitted during the course of the reference. The adjudicator had perhaps anticipated this objection, because he made numerous comments in his reasons about how he had not made any decision without being confident that he understood the parties' cases and was able to deal fairly with them. He had set the timetable and kept to it.

The judge (His Honour Judge Toulmin) was prepared to accept these assurances and therefore rejected Birse's case. If he had not felt able to do so, there must be doubt as to whether he would have enforced the decision.

Mr Justice Akenhead considered a similar issue in April last year in *HS Works Ltd v Enterprise Managed Services Ltd* [2009] EWHC 729.

Enterprise is a utilities contactor engaged by Thames Water to carry out clean water and network repair works. HSW is a contractor carrying out highway repair and other construction works as a subcontractor to Enterprise.

In May 2008, HSW sent in its final account for works on a particular package for Thames Water. It totalled just less than £31million. There were disagreements about contra charges and such. In November 2008, HSW threatened adjudication proceedings in relation to £1.2million of contra charges. Some 8 weeks later he decided that Enterprise should pay £1.8m, largely in respect of contra charges. That decision was expressly limited (by the terms of the notice of adjudication) to the contra charges, and was in favour of HSW because of a lack of appropriate withholding notices.

On the same day as the decision, Enterprise gave notice of adjudication in respect of the final account. It relied on an expert report which had not been seen before. In response to objection from HSW it said that it was merely supporting the case that had already been advanced, and was therefore nothing new.

There was considerable argument throughout the adjudication as to what information should be made available to HSW and the adjudicator, and considerable time pressure

because Enterprise was reluctant to extend time for the adjudicator in light of the fact that it was facing an adjudicator's decision in the other adjudication.

The adjudicator found his task quite demanding. 38 lever files were delivered to him "and a number of smaller files". He was given 3 CDs of data. He held a meeting on 18 February 2009, and then had 17 working days to give his decision. There were 51,000 separate jobs involved.

He effectively decided that the value of the final account was £24.8 million, against which there were valid contra charges of £1.56million.

Both parties issued court proceedings to enforce their respective decisions.

Mr Justice Akenhead had no difficulty in respect of the enforceability of the first decision. The adjudicator had not considered the merits of the contra charge claims – he did not need to do so because he had decided that there were no effective withholding notices. That decision should therefore be enforced.

The second adjudication had been about the value of the final account, not the deduction of contra charges, but clearly the valuation of the contra charges was relevant. The expert's report had not been seen before the adjudication started, but it was merely supportive of the case being made – it was not a new argument.

HSW, in arguing that the second decision was not enforceable, argued that the adjudicator should have resigned because the task given to him was so large that he was not able to deal with the issues raised in the time available. But whilst he had found the task demanding, he had not suggested that he was unable to cope. The information provided was not new to HSW, and so there was no breach of natural justice in continuing with the adjudication. It was only in exceptionally rare cases that the adjudicator should resign.

He had not addressed every item of the account and reviewed each one. The items were categorised and he had spot checked the calculations. This was an appropriate way to proceed.

The judge summarised the approach:

"I also bear in mind, in considering these last two topics, that one should remember that this 28 day adjudication period called for in statute, and provided for here contractually by the parties, provides a tight timescale for disputes. Parliament provided for "any" relevant

dispute to be referable to adjudication and must have envisaged that there would be simple as well as the immensely detailed and complex disputes which can arise on a construction contract….. One should not equate necessarily an adjudicator's approach over 28 days with that of a judge or arbitrator who tries the final version of the dispute after exchange of pleadings, evidence and reports over a period of 6 to 18 months. One has to judge what an

adjudicator does against the context of the period provided by the statute or contract."

Both adjudicators' decisions were therefore enforceable.

Mr Justice Akenhead did not seem very interested in the suggestion that some disputes were too complex for adjudication – his approach was to accept that adjudicators had to adopt whatever procedures were necessary to get the job done.

Mr Justice Coulson then got involved in December 2009 in the case of *Enterprise Managed Services Ltd v Tony McFadden Utilities Ltd* [2009] EWHC 3222

A Thames Water group company "Subterra" engaged Tony McFadden Ltd to carry out repair and maintenance of mains and service pipes in North London in 2002. The project was known as "NLSDA". Enterprise acquired Subterra in 2003. The NLSDA subcontract with McFadden was novated to Enterprise.

In 2004, Enterprises's main contract with Thames Water was terminated, and so Enterprise also terminated McFadden's NLSDA subcontract. Subsequently however, Enterprise entered into several further contracts with McFadden, including one known as the "Lot 8 Sub-Contract" (apparently the same project as the one that had involved HS Works Ltd).

In May 2006, McFadden went into administration and the Lot 8 Sub-Contract was terminated. The administrators submitted a final account, seeking a balance of £2.5million. The company then went into liquidation.

Whilst McFadden claimed about £2.5million from Enterprise, Enterprise considered that it had overpaid McFadden by some £3million.

McFadden (in liquidation) assigned its claims against Enterprise on the NLSDA and Lot 8 projects to Tony McFadden Utilities Ltd. Utilities considered that McFadden had been owed £2.5million on the original subcontract, terminated in 2004, and started an adjudication to recover it.

The adjudication had started on 24 September 2009. By the end of November, when the matter came before the court, the date for the decision had been extended to 23 December. Enterprise sought a total of 12 declarations, by which they hoped to squash the adjudication. Utilities sought the same number of declarations in opposite terms.

Mr Justice Coulson recast the cases so that less than 12 decisions were needed. He started by deciding that there had been a valid novation from Subterra and Enterprise. That was reasonably simple, although hotly contested.

The question of just what had been assigned to Utilities was more difficult. Rule 4.90 of the Insolvency Rules, familiar to construction lawyers since the Court of Appeal decision in *Bouygues UK Ltd v Dahl-Jensen Ltd* [2000] BLR 522, was relevant. Following the House of Lords decision in *Stein v Blake* [1996] 1 AC 243, choses in action represented by cross claims were not capable of being assigned. All that could be assigned was the net balance due between the parties.

Utilities had addressed this problem in the assignment. It purported to assign the debt due under the original Subterra contract separately from the debt alleged due on the subsequent Lot 8 contract, seeking the net balance on the Subterra contract separately from the net balance on the later contract. But that was not possible – the rights under the individual contracts had merged on liquidation, and only the net balance of the total account between the parties was capable of being assigned. The assignment had effectively assigned just that.

This claim, for the whole balance on all the contracts, was not something that could be referred to adjudication. An adjudicator under the Act can only deal with one contract at a time, not several. Also one of the relevant contracts had been for van hire, not a construction contract.

Further, in order to deal with the balance of the account including the cross claims, it would be necessary to bring in the liquidators, making the adjudication tri-partite, which was impossible, and to deal with the claims one at a time would mean that there could be no "temporary finality" to enable any bone to be enforced. It just wouldn't work.

So Enterprise was successful. The adjudicator had no jurisdiction.

Mr Justice Coulson was not going to stop there. He decided to make comments on the process "not only because I have firm views on this topic".

The claim by Utilities on the NLSDA contract was for £2.5million. To understand it, as it was a final account balance, it was necessary to consider the full account of £7 million. The supporting material filled 40 lever arch files. The material on the Lot 8 cross claim was similar. Just on the basis of size, this may not have been appropriate for adjudication.

As suggested by Judge Toulmin in *CIB Properties Ltd v Birse Construction*, the adjudicator in such cases must consider whether he can deal with the matter within the time prescribed, and if he cannot then he should resign. In this case, the adjudicator had not considered the question. He had immediately asked for an extra 14 days. That still was not going to be enough. Piecemeal extensions were then given until the period became 3 months.

"Piecemeal extensions in large and paper-heavy Final Account disputes are not what the Act was designed for. The enthusiasm on the part of some adjudicators to permit "creep" in these cases should be curbed. Obviously, if the parties are agreed at the outset that the adjudicator's time for his decision should be extended by 2 or 3 months, then there is no difficulty. But in this case, there was no such agreement; on the contrary, there were disagreements about everything, including complexity and extensions of time, as well as the adjudicator's jurisdiction. That all demonstrates, in my judgment, that this large Final Account claim was never suitable for adjudication."

Those comments were not the basis of the decision but seemed to suggest that before long he would find it appropriate to decline enforcement because of the complexity of the dispute.

Mr Justice Coulson had another opportunity in February this year in *Amec Group Ltd v Thames Water Utilities Ltd* [2010] EWHC 419

This case involved a framework agreement, and separate but related works contracts for construction and maintenance work in and around London. Amec made a claim under the framework agreement for sums due across a wide range of works contracts. Thames relied on notices of withholding in which it had raised cross claims. The claim went to adjudication, and the adjudicator decided that Thames owed Amec a little under £1million.

Thames resisted enforcement on several grounds. First it said that the dispute arose under the various works contracts, and so the adjudicator did not have jurisdiction. This failed, because the claim had in reality been made under the one framework contract.

Thames also argued that there had been a breach of natural justice because the adjudicator had not considered its further response, which had been served shortly before the decision was due. Mr Justice Coulson made a comment that will have been welcomed by all adjudicators:

"…it is becoming very common for parties in adjudication to believe that they are in some way entitled to respond to every submission put in by the other party. In my view, unless the contract or the relevant adjudication rules expressly permit it, they do not have such an entitlement. Adjudication is not intended to resolve disputes by reference to innumerable rounds of submissions or pleadings."

An adjudicator would not be acting in breach of natural justice if he simply glanced at material received just 2 days before the date for his decision, to see its general nature and top see if it contained anything of real significance.

Then there was a further argument by Thames, no doubt having in mind the decision of Mr Justice Coulson in *Enterprise Managed Services Ltd v Tony McFadden Utilities Ltd.* Thames said that the dispute was too big or too complex to be resolved in adjudication. On receipt of the referral they threatened a response with 200 lever arch files and a database (although in the end they produced merely 50 files with no database).

Thames failed on this too. The test was not just of size, but whether the adjudicator was able to reach a fair decision within the time allowed. In this case there were only (!!!) 60 or 70 files, the sums at stake were not huge, the complexity was largely the responsibility of Thames itself, and the adjudicator dealt properly with the issues in the time allowed.

Pulling the threads of that sequence of cases together, there seems whilst the judges of the TCC have not yet been prepared to deny enforcement on the basis that the complexity of the dispute has made adjudication an inherently unfair process and the decision therefore unenforceable, they are thinking about it, some more than others. There is however a common recognition amongst them that the time constraints of adjudication may make it impossible for the adjudicator to analyse the issues in as much depth as an arbitrator or judge. That might suit one of the parties, but it unlikely to suit both.

2. THE ALTERNATIVES - LITIGATION

Traditional litigation may be a much more sensible choice than adjudication. If the payer has made a deduction from sums due in circumstances where a withholding notice should have been served, it may be clear that there is no arguable defence. The issue of a claim in the Technology and Construction Court followed by an application for summary judgment may be the most efficient way to proceed. It may be quicker than adjudication followed by an application to enforce, it will probably be cheaper and costs should be recovered.

Litigation may also be the right choice in very large disputes. Of course it will take longer than adjudication, although adjudication in complex cases can be drawn out for several months. It will probably be more expensive, but again parties can spend many hundreds of thousands of pounds in adjudication. The important difference is that the successful party will expect to recover a large part of its costs which could be a very significant factor.

There is also the expectation of a more reliable result. The issues will be fully developed in formal pleadings, there will be disclosure, time for proper preparation of evidence (including expert evidence) and there will be cross examination at trial. The result will be permanently binding with no risk of having to go through the whole process again before a different tribunal.

3. ARBITRATION

Arbitration used to be the main method of dispute resolution in the UK construction industries. It fell out of favour because of the difficulty of joining third parties and multiple defendants. It was also perceived as being even slower and more expensive than litigation. Unless you were lucky enough to have chosen one of a select band of top arbitrators (who were far too busy) these criticisms were justified.

There were two pieces of legislation in 1996 that were to affect construction arbitration very significantly. The first was the Arbitration Act, which radically simplified and strengthened the arbitration process, restricting the ability of parties to derail the process by going off to court and encouraging the arbitrators to adopt innovative procedures that would make arbitration much more efficient.

The second was of course the Housing Grants etc Act which created adjudication as we know it today. Just as arbitrators were being empowered, their market was largely destroyed. Disputes were automatically taken to adjudication, whether or not the process was really suitable. As a result, most construction arbitrators became adjudicators. They

rapidly became used to the idea that they could reach a decision within 28 days instead of 28 months.

If you do take a dispute to arbitration today you will probably find yourself in a very different process than you would have experienced pre 1996. The arbitrator will have a great deal of experience of adjudication. He will be used to the suggestion that a submission cannot be prepared in 7 days and an extension to 10 days is sensible. Extensions of several months will be difficult to justify. He is likely to be much more creative about taking preliminary issues, "hot tubbing" with experts, limiting disclosure to essentials and dealing with some matters on paper where appropriate.

Whereas it was always thought that arbitrators should be more efficient than courts, very often they were not. Today's arbitrators really can be.

Of course arbitration is only an option if there is an arbitration clause in the contract or the parties agree after the dispute has developed. This might be difficult to achieve, but it might be worth asking.

3. SOCIETY OF CONSTRUCTION ARBITRATORS 100 DAY ARBITRATION PROCEDURE

The wish to bring some of the efficiency of the adjudication process into the world of arbitration led to the publication in 2004 of the Society of Construction Arbitrators 100 day arbitration procedure. It was generally welcomed by the industry at the time but has not been widely used since. As the Society seldom appoints arbitrators and does not maintain any control on the use of the procedure which can be downloaded without charge at its website, www.constructionarbitrators.org , no records exist as to the extent of use, but it does not seem to have proved popular.

Recently however there has been much greater interest. This is at a time when the growth in adjudication appears to have peaked.[1] The Society now receives regular enquiries about the procedure and how it can be used. This may be because some in the construction industry are seeking a dispute resolution method that is final, allows the use of disclosure and full oral hearing, enables cost recovery, has the statutory backing of the Arbitration Act 1996 and yet does not allow the dispute to drag on for a year or more.

[1] The RICS reports that in the period August 2009 to March 2010 it received 510 applications for appointment compared with 609 in the same period 2008-9. The numbers do however vary considerably each month.

The title "100 day" is a little misleading, as indeed is 28 days in adjudication. The 100 days runs from the delivery of the defence (or defence to counterclaim), or the arbitrator's procedural directions if later. The parties can agree an extension of the period, but the arbitrator cannot require such extension.

The arbitrator is required to give directions for very speedy exchange of further paperwork, including witness statements, experts reports etc. The hearing must not exceed 2 weeks, and the arbitrator is obliged to make his award within 30 days from the end of the hearing.

Of course, as with any arbitration and unlike adjudication, this procedure is only available if both parties agree, either in the contract or subsequently. Often, the speed of the process will be very attractive to one party and for that reason very unattractive to the other. On the other hand, when faced with a claimant determined to press ahead, a respondent who believes in his case may prefer the 100 day arbitration approach allowing the prospect of cost recovery and the other advantages already discussed.