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REVIEW

Adjudication – Building a new future to resolve construction disputes

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Introduction

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Advocate John T Aycock and Barrister Richard N.M. Anderson review .....

Barrister Richard N.M. Anderson and Advocate John T Aycock look at adjudication in practice and explain how the recently introduced adjudication provisions should assist in dealing with Manx building disputes

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Adjudication – Building a new future to resolve construction disputes

INTRODUCTION

YOU CAN always tell a growth economy by the number of cranes punctuating the skyline. The building work still evident in Douglas, Isle of Man is a clear sign that the Manx economy remains vibrant.

But building and large capital projects inevitably bring with them the occasional dispute. The new adjudication provisions set out in recent Manx legislation, if the pattern in the UK is to be followed, should pave the way to more efficient dispute resolution in the Manx construction industry.

In a little-noticed statute called the Construction Contracts Act of 2004 together with an associated set of Regulations called the Construction Contracts Scheme Regulations 2004 (both of which came into effect on 1 June 2004), Tynwald introduced into the laws of the Isle of Man certain provisions relating to payment and dispute resolution (using a concept known as 'adjudication') for certain types of contract to be known as 'construction contracts' (as statutorily defined). Tynwald is not alone in this for the success of those concepts in Britain has also led to their adoption by the Government of New Zealand; most of the States of Australia; and Singapore and Malaysia. This article examines the background circumstances which gave rise to the introduction of the concepts of payment and adjudication in Britain and casts an eye over the terms of the Isle of Man legislation.

BACKGROUND

The one concept which tends to be at the forefront of the minds of all parties involved in a construction project is payment – both the giving and receiving of it. Traditionally, in Britain at least, employers simply described (often verbally) the type of building they wished constructed and contractors agreed to do so for a fixed price payable in one lump sum on completion to the satisfaction of the employer. Of course, a legal overlay arose in relation to such contracts which the common law interpreted as 'entire' (the construction had to be completed before an entitlement to payment arose) and then, to cater for the situation of unreasonable refusal to accept, also had to develop a doctrine of 'substantial completion'. Circumstances changed, however. Employers began to engage technical advisors. Contractors began to engage sub-contractors.

Perhaps the most significant change, however, was that contractors were no longer prepared to accept payment in one lump sum on completion and instead insisted upon periodical payments to cater for the rising costs of materials, sub-contractors etc. Here again payment raised its ugly head with contractors anxious to ensure receipt of payment in full for the work done to date and employers equally anxious to ensure that they only made payment for work properly done. Some method had to be found for balancing these competing interests. The method devised in Britain was to use the services of the architect/engineer. In terms of the contract that individual is the representative and agent of the employer but also in terms of the contract (later reflected in standard form contracts), and also supported by the common law, the architect/engineer was required to 'wear two hats' and required to act impartially in striking that balance between the employer and the contractor. Their decision was normally issued in the form of a Certificate of Interim Payment. This was a system which worked well in Britain and elsewhere for many years.

Once again, however, circumstances changed and, on this occasion, the major change was economic. Britain fell into an economic recession which impacted strongly upon its very competitive construction industry An incautious remark by the then Board of Trade led to a constriction in what was later memorably described as the construction industry's 'lifeblood' – the chain of payments from employer to main contractor and from main contractor to sub-contractor. The result, which did not go judicially unnoticed, was that many otherwise reputable contractors (and especially the sub-contractors at the bottom of the chain) were being driven into insolvency. Unsurprisingly, they turned to the common law in Britain for a solution and the first case in which that was attempted was a case called DAWNAYS LTD v F.G. MINTER LTD and TROLLOPE AND COLLS LTD [1971] 1 WLR 1205. In this case Dawnays were specialist steelwork sub-contractors. It had been suggested that they arrived late on site and that some of their work was defective but they completed the steelwork and sent in their Account. The main contractors passed that account together with their own to the employer. The architect certified payment. The employer paid the main contractor who raised a contra-account for delay (not a matter that the architect considered in terms of the contract) which in fact exceeded the payment due to Dawnays, the sub-contractors. In terms of the standard (RIBA) contract used, any arbitration had to await completion of the main works. Dawnays therefore raised a Summons in which they claimed that as the moneys due to them had been certified by the architect and paid over by the employer, they now required to be paid over to the sub-contractors. The matter went to the Court of Appeal where the late, great, Lord Denning agreed. Such Certificates,he opined, were like Bills of Exchange.

Payment of them had to be observed and if the main contractor wished to dispute the matter then they would require to raise the issue in arbitration once the Main Works had been completed (i.e. Pay Now And Argue Later).

The construction industry as a whole was startled and a measure of their shock is, perhaps, reflected in the fact that in the following year no less than six attempts were made (unsuccessfully) to have that decision (which became known as Dawnays' Rule) overturned in the Court of Appeal. Eventually, however, they succeeded in getting one case to the House of Lords and that case was GILBERT-ASH (NORTHERN) LTD v MODERN ENGINEERING (BRISTOL) LTD [1974] AC 689. In that case, their Lordships went back to first principles and out of that struck down Dawnays' Rule but in doing so provided the solution to the problem. Their Lordships held that the construction industry and any cashflow considerations that it might have were not entitled to any special consideration under the law. 'Dawnays' Rule' was no more. Their Lordships also held that rights of diminution and set-off were common law rights that could validly be contained within a contra account but – crucially – also held that it was competent to vary those rights within the contract.

Sub-contractors, especially, were not slow to take the hint. Their Associations instructed the doyens of the English Bar.

By that time, also, a certain amount of disenchantment had set in about architects/engineers wearing 'two hats' and the resultant contract (which first appeared in a sub-contract then known as the 'Green Form') provided for a completely independent person – known as an 'Adjudicator' – to arrive at a temporarily binding decision in relation to any contra account and set off disputes between main contactors and sub-contractors. Initially confined to such set-offs, the concept later spread to other main contracts.

Once again, however, circumstances changed and throughout the 1990's in Britain the most noticeable effect of those changes was an increasingly adversarial attitude within the British construction industry. This became so severe that the Government of the day and the British construction industry jointly commissioned a review of the construction industry by Sir Michael Latham. The Latham Report contained a large number of inter-locking recommendations (including picking up on the payment and adjudication terms in some standard form contracts and recommending that modern construction contracts should make adequate provision for periodical payments and also for the interim resolution of any disputes by independent adjudication) but unfortunately went the same way as other Reports which had preceded it. A change of Government also took place but the situation in Britain was so serious that the sub-contractors'Associations lobbied

Government and persuaded it to insert payment and adjudication provisions into a passing Bill dealing with Housing Grants; Regeneration; Architects and the like. The result, in Britain, was the Housing Grants, Construction and Regeneration Act 1996.
Given that it represented a gross interference with the hallowed principle of 'freedom of contract', this Act (which received something of a rough passage through Parliament) adopted a cautious approach. The Act allows parties to a 'construction contract' (as defined) to provide such terms as they wished in relation to payment and adjudication provided that certain minimum standards set out in that Act were observed, failing which terms contained in secondary legislation known as Schemes for Construction Contracts would be implied by law into the contract of the parties. Schemes were introduced for England & Wales; Scotland and Northern Ireland. Effectively, the British statute introduces Pay Now And Argue Later - a temporarily binding decision by an independent adjudicator which is binding until finally determined – ironically the very thing which Lord Denning tried but failed to introduce under the common law.

THE ISLE OF MAN LEGISLATION

The legislation introduced by Tynwald follows a similar pattern.

The Manx Act applies only to work done on the Island and applies only to contracts – which must be in writing (s. 4) only - entered into after the commencement of the Act (1 June 2004).

In the first place, the 'construction contracts' to which this new legislation will apply is statutorily defined. S. 1 provides that in this Act a 'construction contract' means the carrying out of 'construction operations' and also sub-contracting and labour-only contracts. It includes contracts with architects and engineers. It excludes contracts of employment.

'Construction Operations' are more closely defined in s. 2 of the Act. The definition is a wide one which would cover most normal construction contracts. However, certain sectors – such as Oil and Gas; Nuclear; Power; Water Chemicals; Pharmaceuticals - lobbied (apparently on the grounds that their payment and dispute resolution procedures are already good enough) to have themselves excluded from the operation of the Act. The Department of Trade has retained the power to add to or delete from these provisions. A construction contract with a residential occupier is presently excluded (s.3).

For such contracts, the Act carries a statutory entitlement to periodical or stage payments (s.6) and to dates for payment (s. 7). These are the 'minimum standards' as to payment which are expected to be found in parties' construction contracts failing which the Act implies the terms of the Isle of Man secondary legislation.

The most important section in practice is likely to be s. 8 which requires a party intending to withhold payment to provide a Notice of Intention to Withhold Payment. There is also a statutory right to suspend performance for payment. There is also a prohibition on conditional payment provisions. Some of the supplementary provisions relating to service of notice etc are also likely to be quite important in practice.

The Act also carries an entitlement (not an obligation) to refer 'a dispute arising under the contract' (almost invariably relating to payment in practice) for adjudication. The 'minimum standards' here (s.5) are that the parties' contract shall –

1) enable a party to give notice at any time of his intention to refer a dispute to adjudication
2) provide a timetable with the object of securing the appointment of the Adjudicator and the referral of the dispute to him within 7 days of such notice
3) require the Adjudicator to reach a decision within 28 days of referral or such longer period as is agreed by the parties after the dispute has been referred
4) allow the Adjudicator to extend the period of 28 days by up to 14 days, with the consent of the party by whom the dispute was referred
5) impose a duty on the Adjudicator to act impartially
6) enable the Adjudicator to take the initiative in ascertaining the facts and the law
7) provide that the decision of the Adjudicator is binding until the dispute is finally determined by agreement, arbitration (if the contract so provides or the parties agree) or litigation
8) provide that the Adjudicator has immunity.

If the parties' contract does not adequately reflect these terms then (by s. 5(6)) the Act implies into their contract the terms of the Isle of Man Construction Contracts Scheme Regulations. These have been well drafted by Tynwald and will cater for almost all payment and adjudication situations. There is, however, no requirement (here or in Britain) for Adjudicators to be specially trained in any way.

SUMMARY AND CONCLUSIONS

The introduction of payment and adjudication provisions into Britain was for a time greeted with something of stunned silence by the construction industry there. The most significant factor was the first case on the subject (very ably heard by His Honour Judge Dyson, now Lord Justice Dyson). There were a few teething problems at first. Since then, there have been about 300 cases in England and Wales and Scotland. After something of a steep learning curve, payment and adjudication (currently undergoing review) is considered to work well in Britain. The number of arbitrations have fallen to one-third of former levels

and the specialist construction courts are short of work! Perhaps a measure of its success is that in practice only a handful of these 'temporary' decisions by Adjudicators are being taken forward for final determination. It is reasonable to anticipate a similar outcome in the Isle of Man.

THE AUTHORS

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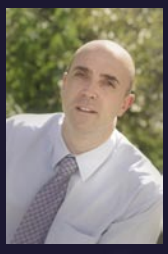

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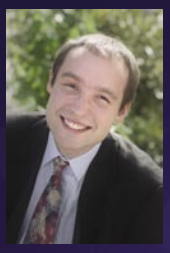

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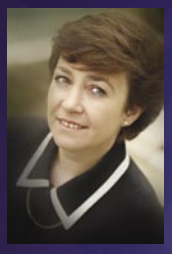

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