The opportunity to adjudicate would have increased a settlement amount by almost 70%: findings in the judgement on quantum between Imperial Chemical Industries and Merit Merrell Technology [2018]

It is unusual for construction disputes in the UK to be litigated 'all the way' such that a high court judge is called upon to wade through the hundreds, possibly thousands of items that typically make up a final account dispute. Commercial common sense will usually prevail at some point beforehand.

So long as they are permitted to do so, experienced quantity surveyors can resolve most accounts without a dispute ever starting. However if an account is particularly problematic, adjudication is now the preferred route for obtaining a third party decision. If there is a pressing point of law or a demanding matter of principle / liability, then declarations can be sought from the court. Alternatively proceedings can be bifurcated, so that liability can be addressed separately and in advance of quantum. The aim of all this is to unlock the overall dispute without the need for a court to pick through the vast amount of information that is necessary to value work on a construction project.

As always, there are exceptions and we get to see how a high court judge might deal with such matters. To which end, this article examines *Imperial Chemical Industries v Merit Merrell Technology Limited*[1].

ICI v MMT

MMT was contracted to install steelwork within ICI's new paint manufacturing facility in Ashington, Northumberland. The contract was governed by the NEC3 conditions of contract and the Contract Sum was around £1.9 million. However, during the project the scope of MMTs work was vastly increased by instructions to install approximately 42,000m of engineering pipework. These instructions had to be valued as compensation events under the contract.

Despite the increased work scope ICI, the Project Manager and MMT all managed to get along professionally. The compensation events were valued without inordinate difficulty, using rates that had been included within the contract documentation. The wheels only came off the wagon when ICI's parent company (AkzoNobel) realised it was heading towards a substantial overspend. They sent an executive to visit the site. Matters quickly deteriorated from that moment on...

The executive took the following action:

- He interfered with the certification duties of the Project Manager to such an extent that the Project Manager considered that he had no option but to resign;
- He failed to appoint a replacement Project Manager, deciding instead to take over the

[1] [2018] EWHC 1577 (TCC).

role himself. He was described by the court as *"eminently unsuitable in every respect"* to carry out the 3rd party certification duties required of someone in that role;
- He alleged that MMT's works were substantially defective;
- He deprived MMT of further payment by applying contra charges *"to suit the level"* that ICI was *"happy with"*;
- He made promises of payment to MMT with no intention of ever following through;
- He conveniently ignored the findings of an audit which showed that ICI owed MMT considerably more money;
- He promoted the idea within AkzoNobel that it could be of commercial advantage to ICI if MMT became insolvent;
- He dismissed MMT from site and prevented MMT from removing its documents (including details of the valuation of the compensation events, which had previously been agreed;
- He commissioned an external consultant to value MMT's works without regard to any of the measurements and rates that MMT had previously agreed with ICI's site personnel; and
- Lastly, using the valuation, carried out by the consultant above, he alleged that MMT had been vastly overpaid.

These actions put MMT under considerable financial strain and eventually caused it to make plans to enter into a Company Voluntary Arrangement (CVA). Rumours of MMT's predicament spread within the industry and compromised MMT's commercial position on other projects.

Luckily for MMT, amid all this difficulty, ICI made the most serious of blunders. It failed to issue payment and pay less notices following MMT's interim applications for payment. Now, because of that failure, MMT had a statutory entitlement to be paid the amount applied for (approximately £9.1m). MMT commenced adjudication proceedings and eventually obtained full payment of this amount.

However MMT were not quite out of the woods just yet. As soon as the sum was banked, MMT's bank withdrew lending facilities. To continue trading, MMT had to move its banking elsewhere under less favourable terms. Ultimately MMT restructured the business by placing the trading business into the control of its holding company, MHL. MMT was eventually placed into voluntary liquidation.

The liability and quantum trials

HHJ Fraser QC took a very dim view of ICI's conduct. In the liability trial of 2017 it was held that MMT's works were nowhere near as defective as had been alleged and thus ICI was in repudiatory breach of contract for removing MMT from site[2]. ICI pressed on with its case regardless, alleging that MMT had been over-paid by approximately £10.9 million. The 2018 judgement on quantum is, therefore, comprised of two parts:

i) The value of MMT's account at the date of repudiation; and

ii) MMT's counterclaim of damages for ICI's wrongful repudiation of the contract.

Ultimately, ICI was trounced in the quantum trial. Rather than being overpaid by approximately £10.9 million, it was found that MMT was entitled to a further payment of £268,425 on the final account, together with £2,047,170 of damages arising from the counter-claim.

There are various points within the judgement concerning quantum that are of particular interest…

1. The Burden of Proof is on the party alleging overpayment, even if the reason for the alleged overpayment is as a result of adjudication

The question of who bore the burden of proof was of particular importance. Not least because, thanks to the actions of AkzoNobel, MMT was no longer in possession of documentation to support some of the amounts it had been paid. During the trial this did not stop ICI from submitting that MMT had to prove the value of its work.

Mr Justice Fraser concluded that the burden of proof was on ICI. After all, it was seeking to demonstrate an entitlement to be repaid money. He stated that *"it does not matter whether a party such as MMT holds the money as a result of a decision by an adjudicator on the substantive value of an interim application, or because of the absence of a payless notice"*.

The Court of Appeal has recently confirmed in *S&T (UK) Ltd v Grove Developments Ltd*[3] that a *"true value"* dispute can be adjudicated by the paying party regardless of its failure to issue a payment or pay less notice. However there are still many advantages to a payee if it adjudicates for the notified amount first and one such advantage is that the burden of proof falls to the other party (the referring party) in the 2nd adjudication (i.e. the *"true value"* adjudication), as by that point it will be asserting that it has overpaid. The paying party will usually find it difficult to discharge that burden if it has been in the habit of making arbitrary

[2] [2017] EWHC 1763 (TCC).
[3] [2018] EWCA Civ 2448

deductions from valuations submitted by the payee, rather than diligently engaging in the valuation of the work itself.

ICI, together with its external consultant and quantum expert, took extreme positions by ignoring the contract Schedule of Rates, relying on absent documentation and valuing works that had been done at nil or low cost. As a result it got nowhere close to discharging its burden and Fraser J saw no good reason to depart from MMT's valuations, especially given that many of these valuations had been agreed at site level before AkzoNobel's executive arrived.

One can speculate that an adjudicator with a background in quantity surveying may have made some downward adjustments to MMT's valuations. For example, MMT's account included a charge of £519.75 per hour for the time its managing director spent dealing with the ICI commissioned audit (the rate was derived from the cost to MMT of the managing director's remuneration package). Percentages for preliminaries and the fee were then added on top. On the face of it, this would seem peculiar. A managing director would usually be a head office overhead, and thus deemed to be included within the fee under an NEC contract. He would not usually be site based to attract the cost of site preliminaries. The fact that MMT's claim was accepted by the court reflected i) the need, as Fraser J saw it, for all the compensation events to be assessed in a consistent manner; ii) the unconventional manner in which the contract data in the NEC3 contract appears to have been completed; and iii) the fact that ICI's alternative valuation was unreasonably low and therefore couldn't be used. Perhaps an adjudicator might not see these points in the same context as Fraser J, and come to a different conclusion.

2. Absence of a formal instruction does not justify non-payment

Again and again, when dealing with problematic final accounts, we see payment requests for additional work being refused on the basis that formal instructions have not been issued. This problem is exacerbated by contractors who get into the loose habit of acting on informal instructions conveyed in emails and at meetings. Were contractors more disciplined about insisting upon full formal instructions drafted to encapsulate all additional work (including additional management and administration duties) this recurring problem would likely be resolved. In any case, relying on a failure to formalise instructions as an excuse for non-payment was (rightly) given short shrift by the count:

> *"Nor do I consider that the lack of a particular PMI in relation to work instructed by means of an SI is an adequate justification for not valuing the works. MMT is not to blame for such a failure to issue a PMI. MMT received an instruction on site – namely each SI – to do particular work; the fact that this instruction did not evolve into a PMI does not mean ICI is entitled to the benefit of that work for nothing, or that MMT has to do such work at its own cost."*

3. It is wrong to penalise a party for commencing adjudication

It became apparent during the quantum trial that one of the (unlawful) reasons MMT was dismissed from the site was that MMT had commenced adjudication proceedings, and therefore AkzoNobel's executive was no longer prepared to work with MMT. According to Fraser J this put ICI in an *"even worse light"*. A party to a construction contract has a legal right, bestowed by parliament for the benefit of the industry as a whole, to initiate adjudication proceedings at any time. Penalising a firm for exercising its legal right is bad policy both ethically and commercially.

4. The losses recoverable in the counterclaim

Undoubtedly the most intriguing aspect of this case, from a technical point of view, was how the court decided MMT's counterclaim. MMT was entitled to damages due to ICI's breaches, including its failure to pay the amount due in the absence of a pay less notice. Fraser J made it clear that ICI could not plead ignorance about the effect of its breach:

> *"Anyone with the sketchiest grasp of business reality would realise the potentially catastrophic effect of such deliberate, and wholly unjustified, non-payment. This would also have been known at ICI at the time the contract was formed"*

The effect of the non-payment was that MMT incurred costs; it had to prepare itself for entering into a CVA, change banking facilities and borrow money on less favourable terms. ICI was held liable for all these costs, including the associated fees.

The cost of management time incurred as a result of ICI's behaviour was also recoverable, extending from when ICI's behaviour became repudiatory up to when the new banking arrangements had been put in place. It is interesting to note that there were no time sheets in support of the hours claimed but that the court accepted MMT's method of allocating time to each item of documentation, including the many thousands of emails from that time.

Part of this management time had been spent on the adjudication itself and was therefore not recoverable as *"conducting an adjudication is something that management of a company should expect to do in any event, and recovery of such costs seems to be very similar to recovering costs in an adjudication"*. As the specific amount of time spent on the adjudication was not easy to identify, the court reduced MMT's claim for management costs over the recovery period by 20%.

As would be expected, MMT was also entitled to loss of profit on work that had been instructed but not carried out due to MMT's eviction from the site.

In addition to these more obvious heads of damages, ICI was also held liable for £1.3 million because MMT's negotiation position on another contract was compromised by the CVA. MMT had been in negotiations to resolve a disputed account with Murphy (the main contractor on this other project). As MMT had announced that it was prepared to adjudicate, a settlement figure of £3.2 million had been tabled. However, upon learning that MMT was about to enter a CVA, Murphy retracted its settlement proposal. Murphy recognised that, due to MMT's precarious financial position, an adjudicator's decision obtained in MMT's favour would most probably be unenforceable[4]. If there is no immediate threat, there's no need to capitulate. So, because ICI was responsible for the financial difficulties, the court found that it was also responsible for Murphy's opportunistic behaviour, which *"was caused as a result of ICI's conduct on the project and was to take advantage of the grave difficulties caused to MMT by ICI's breach of contract"*. In the circumstances, the best that MMT could do was to settle the account with Murphy for £1.9 million, instead of the £3.2 million that was previously on the table when adjudication loomed. Thus, the balance of £1.3 million was recoverable from ICI as damages for breach of contract.

Some other elements of the counterclaim did not succeed, as they were considered too remote or because the costs were incurred by MHL and not by MMT. For example, i) the legal fees incurred in the dispute with Murphy, ii) the acceptance of a lower than expected settlement offer in arbitration (MMT did not have the resource to fight on two fronts) and iii) the costs of liquidating MMT.

Summary

The findings outlined above are fact specific, and must be considered in context. The judge took a dim view of ICI's conduct, and that of its representatives. If there is a common thread throughout the quantum judgement, however, it is the benefit of statutory adjudication to cashflow. Although MMT entered a period of financial distress caused by ICI's conduct, it largely overcame this problem within a period of 6 months by successfully adjudicating the amount it had applied for. Without this adjudication the period of distress would have lasted years. Despite having years to prepare its case for court ICI was unable to recoup any of this amount in its *"true value"* litigation. ICI wholly failed to discharge its burden of proof and the extreme positions that ICI adopted gave the court no reason for dislodging the amounts that MMT had submitted and already been paid for.

In contrast, the detriment caused when adjudication is unavailable is made evident from that fact that had MMT been financially strong enough to follow through on a threat to adjudicate against Murphy, the settlement amount would have increased by almost 70%. Notwithstanding the fact that the dispute between MMT and Murphy was completely unrelated to ICI's project, ICI was held liable for the reduction in the settlement amount, as it was responsible for damaging MMT's financial position.

[4] Following the principles governing stays of execution upon adjudication enforcement as set out by HHJ Coulson QC (as he was then) in *Wimbledon Construction Company 2000 Ltd v Derek Vago* [2005] EWHC 1086 (TCC).

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