# A PROPOSAL FOR A DUAL PROCESS OF ADJUDICATION

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This paper describes how a dual process of adjudication would solve many of the perceived problems with adjudication in the building and construction industry. The proposed dual process is a combination of the existing process of adjudication in NSW, Victoria and Queensland, which I shall call the certification process, and the process of adjudication in the UK, WA, NT and NZ which I shall call the traditional process.

Under the dual process, the procedure for adjudicating progress claims would be slightly different to the procedure for adjudicating claims for debt or damages which I shall call ex–contractual claims.

The paper is set out in the following order:

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## BACKGROUND

There are two types of money claims which can arise out of a construction contract. One is a claim for a debt payable under the contract. The other is a claim for damages for breach of contract. Claims for debt and damages can be made in the courts. A progress claim cannot be made in a court.

Progress claims are an invention of construction contracts not of the courts. Since a progress claim cannot be made in a court, a system had to be devised to quantify the amount of a progress payment. For well over 100 years construction contracts have sought to solve that problem by creating a certifier, sometimes titled the architect, the engineer, the superintendent or the principal's representative, who certifies the amount of the progress payment due. The contract then provides that the other party must pay the certified amount by a certain date [the due date for payment]. This works well so long as there is a competent certifier who acts on time, independently and fairly and the other party actually pays the certified amount on time. If the amount is not paid by the due date for payment, there is a debt [the certified amount]. The claimant can sue in the courts for the debt created by the certificate or for damages for breach of contract.

There were many problems with the process of contractual certification. Often the certifier did not act independently and fairly. Sometimes a certificate was not issued or not issued on time. Sometimes the other party failed to pay the certified amount. Actions for debt or damages were often met with cross claims and took months if not years to resolve, by which stage the contract would be at an end. Then a final decision could be made on the entitlements of the parties and there would be no point in a payment on account.

For the vast majority of smaller contractors, subcontractors, consultants and suppliers of related goods and services, there was not even a process of contractual certification. They had no way of enforcing progress payments.

## THE TRADITIONAL PROCESS

Two different types of statutory adjudication have been devised to deal with cash flow problems

in the construction industry. The first, which I call the traditional process, was introduced in England in Part 11 of the Housing Grants, Construction and Regeneration Act 1996. It was introduced to implement recommendations in the report of Sir Michael Latham into cash flow problems in the construction industry in the UK. The traditional process allows either party to a construction contract to refer a dispute arising under the contract to adjudication. Just as either party could traditionally sue in the courts for a debt or damages, either party can refer a claim for debt or damages to adjudication. The traditional process was subsequently adopted, with modifications, in NZ, WA and NT.

The traditional process adopted in NZ by the Construction Contracts Act 2002 allows either party to a construction contract to refer to adjudication [s25] any 'dispute'. A dispute is defined as 'a dispute or difference that arises under a construction contract' [s5]. But only an adjudication determination that a party is liable to pay money is enforceable [s58]. Determinations on other questions of rights or liabilities are unenforceable. Western Australia in the Construction Contracts Act 2004 allows either party to a construction contract to refer to adjudication [s25] a 'payment dispute'. A payment dispute is a claim for money or for release of any security due to be returned by a party [s6]. The NT legislation follows closely the WA Act. I have called a process, such as that in the UK, NZ, WA and NT, the traditional process because it does not specify that only one party can make claims and it is not limited to a specific type of money claim under a contract. The traditional process mirrors a court process.

## THE CERTIFICATION PROCESS

The certification process was first created by the Building and Construction Industry Security of Payment Act 1999 NSW. This process was adopted in the Building and Construction Industry Security of Payment Act 2002 Vic and the Building and Construction Industry Payments Act 2004 Qld. I have called it the certification process because the role of the adjudicator is that of a certifier [e.g. the architect, the engineer, the superintendent or the principal's representative]. The adjudicator should only certify the amount of the progress payment due and not decide claims for debt or damages. The certification process mirrors the contractual certification process. It is quite different to a court process.

The certification process does two things. Firstly, for those contracts which already have a certification process, it solves the problem that exists when the contract certifier fails to certify on time or fails to certify independently and fairly or, for other reasons, the certification process breaks down. Secondly, for those contracts which do not have a certification process [these are most of the smaller contracts] it provides a statutory certification process.

The certification process is a mechanism for ensuring that the person carrying out construction work or providing related goods and services is able to have the amount of progress payments decided quickly by an independent certifier and is able to obtain judgment for that amount. Only the person who carries out construction work or provides related goods or services can make claims under the certification process and only progress claims, as defined, are adjudicated.

The certification process has some important advantages in that, because it is limited in scope, it enables rapid and relatively inexpensive adjudication of progress claims. The number of adjudications under the certification process [more than 1,000 a year] illustrate how popular it is. It has enabled thousands of contractors, subcontractors, suppliers and consultants to obtain progress payments quickly and with the minimum of cost. It seems that the average cost of an adjudication under that certification process is about one 20th of the average cost of an adjudication in the UK under the traditional process.

Experience has shown that after adjudication it is very rare for either party to embark on litigation or arbitration to obtain a final decision. In most cases adjudication results in a final resolution of disputes. Adjudication has been working very efficiently and has reduced considerably the number of disputes going to arbitration and litigation. In the UK it has been shown that after a decade of the traditional process, the number of construction claims commenced in the Technology and Construction Court has been reduced by 78% [(2005) 105 ACLN 6].

This statistic relates to larger claims and gives no indication of how many parties to construction contracts have recovered payment by way of adjudication in instances where, due to the costs and difficulties inherent in litigation, they would never have commenced litigation. Because it is faster, less complicated and less costly, the certification process provides an effective remedy where litigation does not.

Courts have no experience with certification. They are not

certifiers. Litigation is similar to the traditional process. It mirrors the process that judges and magistrates are used to. Even when the adjudication is under a certification process, the courts see adjudication in their own image and consequently have regarded the role of an adjudicator as similar to the role of a judge, a magistrate or an arbitrator rather than a certifier.

In NSW, the Supreme Court started off by deciding that the determination of an adjudicator was open to judicial review [just as is the decision of a magistrate or judge] until the Court of Appeal held otherwise in Brodyn v Davenport [2004] NSWCA 394. The NSW Court of Appeal held that an error of law by an adjudicator is not a ground for setting aside an adjudicator's decision. On the other hand, the Queensland Supreme Court has followed the NSW Supreme Court as it was before the Court of Appeal stepped in. In a number of cases the Queensland Supreme Court has held that an adjudicator's decision made under the certification process is open to judicial review and can be set aside for error of law (ACN 060 559 971 Pty Ltd v O'Brien [2007] QSC 91). Consequently, for the moment, the role of an adjudicator is interpreted quite differently in NSW and Queensland. In NSW error of law is not a ground for setting aside an adjudicator's decision. In Queensland it is.

The Supreme Court of NSW has also decided that adjudicators can decide some legal issues going to their jurisdiction. This goes far beyond the role of certification. The court has held that adjudicators must comply with the rules of natural justice. Such rules have application to legal proceedings but not to certification. The courts in both NSW and Queensland have reinterpreted the certification role and construed it as a quasi judicial role. There is presently a Bill before the Queensland Parliament [the Justice and Other Legislation Amendment Bill 2007] to exempt adjudication from judicial review.

Led by the Supreme Court of NSW (Minister for Commerce v Contrax Plumbing [2005] NSWSC 142), NSW courts have allowed progress claims to include some claims for delay costs and damages. Instead of being merely able to use the certification process to recover a progress payment for work actually carried out, some claimants have used it to recover payments on account for damages for breach of contract and payment on account for ambit claims for alleged delay costs. This was not the intention of the legislation. This interpretation results in a broader application of the certification process than was intended. This causes an imbalance because, under the certification process, only one party can refer a claim to adjudication and recover money. Another perceived problem has been labelled the 'ambush claim'. It is the practice of some contractors to leave delay and disruption claims till the end of the contract and include them in one gigantic final progress claim. The respondent then only has 10 business days to analyse and respond to the claim by way of a payment schedule.

Victoria tried to maintain a narrow application of the certification process in the Building and Construction Industry Security of Payment (Amendment) Act 2006 by making an adjudication determination void to the extent that it includes 'excluded amounts' [s23(2B)]. These are defined in s10B to be claims for delay costs and damages and some variation claims. However, this amendment does not address the imbalance that only one party can take advantage of adjudication and it means that many claims are excluded from adjudication.

Another perceived problem with the certification process is that if, at the time for a progress payment, the respondent has not obtained a final determination that the respondent is entitled to an amount in respect of a cross claim, the respondent cannot withhold payment on account of the cross claim. Under the certification process there is no mechanism for the respondent to initiate an adjudication to obtain a determination [on an interim basis] of the respondent's claim. Consequently, when it comes time for a progress payment, the respondent is unable to set off against the progress claim amounts which the respondent claims. There are some exceptions [e.g. where there is an express provision for set off in the construction contract] but there is an imbalance which arises from the fact that the claimant can claim damages in certain circumstances and the respondent cannot. Examples below will illustrate how the dual process both protects the person who has carried out work or supplied goods or services while at the same time allowing the other party an equal right to adjudication of claims.

## THE PROPOSAL FOR A DUAL PROCESS

Why have a dual process and not simply replace the certification process with the traditional process? The principal reason is that the certification process is faster, less expensive and works very efficiently in the vast majority of cases. It is only in those instances where a claimant claims damages or a respondent wants to cross claim for damages or set off a debt against the progress payment that problems

arise. It is the process or absence of a process for adjudicating those claims that requires consideration.

The proposed dual process would retain the certification process for purely progress payment claims, i.e. for claims for the value of work, goods or services that have actually been provided, and would adopt the traditional process for other payment disputes. The dual process would continue the existing legislation for progress claims (redefined to exclude the broader interpretation sometimes adopted by the courts) and would allow either party to have damages and debt claims adjudicated separately.

The dual process of adjudication would be basically the same as now exists but with slightly different rules for dealing with progress claims and ex–contractual claims.

In theory, just as arbitration and litigation can continue concurrently with adjudication, so too adjudication of an ex–contractual claim could continue concurrently with an adjudication of a progress claim. The claimant would not be able to enter judgment twice for the same debt.

Courts have adopted a dual process when it comes to enforcing payment of a superintendent's certificate. They have given the contractor judgment for the certified amount and held that the principal must pursue separately the principal's claim against the contractor for damages for breach of contract. Examples are Blue Chip Pty Ltd v Concrete Constructions Group Pty Ltd (1996) 13 BCL 31, Main Roads Constructions v Samary Enterprises Pty Ltd [2005] VSC 388 and LU Simon Builders Pty Ltd v HD Fowles [1992] 2 VR 189. The proposed dual process mirrors the dual process which courts have adopted.

Presently, in theory in a 12 month contract, under the certification process there can be 24 adjudications. Under the traditional process there can be an unlimited number of adjudications. However, in practice under both processes it is unusual to have more than one adjudication arising out of the one contract. Legislation could provide that if at the time of an adjudication application there is already an adjudication application by one of the parties then the second adjudication application must be referred to the same authorised nominating authority [ANA]. The ANA could, if appropriate, refer the adjudications to the same adjudicator. Under the dual process there is scope for more adjudications but it is likely in practice that the total number of adjudications will remain fairly stable. This is because the majority of adjudication applications are made when the contract work is finished and the parties are finalising claims.

The dual process will not increase the number of disputes under a construction contract. It will mean that all money claims can be dealt with in adjudication where under the certification process not all money claims are covered. The dual process should see a reduction in the number of cases going to the Supreme Court on jurisdictional issues.

The dual process would retain the objective of the certification process. In s3 of the NSW Act it is 'to ensure that any person who undertakes to carry out construction work … is entitled to receive, and is able to recover, progress payments in relation to the carrying out of that work'. But the dual process would also adopt the objective of the traditional process. In s3 of the NZ Act it is to provide 'for the speedy resolution of disputes arising under a

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construction contract' and to provide 'remedies for the recovery of payments under a construction contract'. In the WA Act it is 'to provide a means for adjudicating payment disputes arising under construction contracts'.

To avoid confusion, it is proposed that the term 'claimant' presently used in the certification process to describe the person who contracts to provide work, goods or services, be replaced with the term 'supplier' and the term 'respondent would be replaced by 'purchaser'. The term 'supplier' would describe a person who contracts to supply work, goods or services. The term 'purchaser' would describe the person who is or may be liable to pay the supplier for the work, goods or services. The term 'claimant' would then be used to describe the person who makes a progress claim or an ex–contractual claim. The term 'respondent' would be used to describe the person against whom the claim is made.

In the Construction Contracts Act 2002 NZ, to avoid confusion the terms 'payee' and 'payer' are used. I prefer supplier and purchaser.

Only a supplier could make a progress claim but an ex–contractual claim could be made by a supplier against a purchaser or a purchaser against a supplier.

## PROGRESS CLAIMS UNDER THE DUAL PROCESS

Under the dual process progress claims would be made and adjudicated just as they are now. The basic difference would be that progress claims would be restricted to claims for the value of work actually carried or goods or services actually provided, including work, goods or services comprised in variations, retention moneys and return of cash security. Reasons for withholding payment would be limited to arguments as to the value of work, goods or services, including whether they are defective and the estimated cost of rectifying defects, and the set off of decided amounts. Decided amounts would be agreed amounts or amounts that have been finally decided in litigation, arbitration or expert determination or decided on an interim basis in a separate adjudication.

For example, assume that a construction contract is for the construction of a factory for the lump sum of $1m. Assume that retention moneys are $10,000 and there is also a bank guarantee provided by the contractor for $15,000. The contractor could make progress claims in the usual way for instalments of the contract price and, in due course, refund of retention moneys. If the principal has directed extra work by way of a variation, the contractor could include the value of that work in a progress claim. The contractor's progress claims would be adjudicated in the same way as occurs at present and on the same timetable.

Instead of the current endorsement, 'This is a claim under the … Act', a progress claim would have to have the endorsement, 'This is a progress claim under the … Act'.

A progress claim is for an amount that will be payable after the claim is made. It is payable after the amount is certified by an adjudicator and on the due date decided by the adjudicator. If the progress payment is not made on the due date then there is a statutory debt for which judgment can be entered. Before the due date, there is not a debt.

In a payment schedule the respondent may give as a reason for withholding payment of the progress payment (or part) that the amount claimed is, in fact, for damages and not truly for the value of work, goods or services. An adjudicator would consider the reason and if satisfied that the amount claimed is for damages, the adjudicator would not include it in the adjudicated amount. The claimant could separately make a claim for the alleged damages. That would be an ex–contractual claim that would be separately adjudicated.

Under the Building and Construction Industry Security of Payment Act 2002 (Vic) an ex–contractual claim is an 'excluded amount' and an adjudicator cannot include it in the adjudicated amount. In Victoria, an ex–contractual claim whether by the contractor or the principal (for example, for liquidated damages for delay), cannot be decided in adjudication. Under the proposed dual process both parties would have an equal right to pursue ex–contractual claims in a separate adjudication.

The certification process presently does not encompass claims for release of bank guarantees. It is proposed that this be included as an ex–contractual claim, as is the case under the WA legislation.

## EX–CONTRACTUAL CLAIMS UNDER THE DUAL PROCESS

The legislation could be amended to allow either party to a construction contract to make ex–contractual claims. The claim would have to be endorsed, 'This is an ex–contractual claim under the … Act'. The claim would be for an amount allegedly already due at the date of the claim.

Following are some examples of ex–contractual claims which a contractor might make against the principal:

(a) The principal fails to provide access on the agreed date. The claimant claims damages for the delay.

(b) The superintendent fails to grant an extension of time. The claimant claims damages.

(c) There is a mistake in the contract drawings and the contractor has to demolish work and replace it to overcome the error. The superintendent refuses to direct a variation in writing. The contract provides that without a direction in writing the contractor is not entitled to be paid for the extra work. The contractor claims damages, being the amount that the contractor would have received but for the failure of the principal's superintendent to direct a variation in writing.

(d) The contractor terminates the contract for the default of the principal and sues for damages.

(e) The principal disrupts the work of the contractor and the contractor claims disruption costs as damages.

(f) A claim for release of a bank guarantee.

Following are some examples of ex–contractual claims that the principal might make again the contractor:

(a) Liquidated or general damages for delay in achieving practical completion.

(b) A claim of a right to call up a bank guarantee.

(c) The contractor says that certain work is not part of the contractor's work. The principal disagrees and has the work carried out by another contractor and the principal claims the cost.

(d) The contractor damages the roadway. The council repairs the damage and makes a claim against the principal. The principal claims an indemnity from the contractor.

(e) The superintendent issues a final certificate under the contract that certifies that the contractor is indebted to the principal for an amount. The principal claims the amount from the contractor.

(f) The principal terminates the contract for breach by the contractor and claims damages.

A common practice in the construction industry is for the principal to refuse to pay the final payment and to then raise for the first time cross claims and set offs. These are often labelled 'back charges'. Under the dual process, the principal would be unable to withhold payment unless work is defective or omitted or if it has been decided in final proceedings or in adjudication of an ex–contractual claim that the contractor is liable to the principal for the back charges.

The consequence would be that if the principal wished to deduct liquidated damages from progress payments or set off any other damages or debt, the principal would have to make an ex–contractual claim against the contractor. The principal would be able to do that at any time. However, if the principal delays making the claim until the principal receives the final progress claim, the principal will be too late to make the deduction or set off against that progress claim. The principal can nevertheless pursue the ex–contractual claim to adjudication and the contractor may well have to repay the amount of the final payment claim or portion.

The process for an ex–contractual claim would be that the person claiming would make a claim against the other party to the construction contract for an amount which is allegedly due at the time of the claim. The claim would be endorsed 'This is an ex–contractual claim under the … Act'. The claim would served just as a progress claim is served but, unlike a progress claim, an ex–contractual claim could be served at any time. There would be no 'reference date' for an ex–contractual claim. This is because an ex–contractual claim is for an amount [whether a debt or damages] allegedly due when the claim is made. The respondent would have a prescribed period, e.g. 10 business days to provide a defence. The term 'defence' is recommended to avoid confusion with a payment schedule. A payment schedule is provided in answer to a progress claim.

If no defence is provided within the prescribed time, the claimant would have to give a reminder [similar to a s17(2) notice under the NSW Act] and if no defence was received within, say, another 10 business days, the claimant could initiate an adjudication by making an adjudication application to an authorised nominating authority. The claim would be adjudicated in the usual way. The adjudicator would decide whether the claimant is entitled to the amount demanded or any portion. The adjudicator would not decide a due date for payment, as happens with a progress claim. Either the amount is due at the date of the ex–contractual claim or it is not properly the subject of an ex–contractual claim.

The ex–contractual claim could include a claim for interest up to the date of the adjudicator's determination. In that event, to calculate the interest, the adjudicator would have to decide when, in the past, the claimed amount fell due. The respondent who fails to serve a defence within time would be precluded from making an adjudication response.

The defence could be simply be a defence or it could be a cross claim or both a defence and cross claim. With the above timetable, the respondent would have at least 21 business days to prepare and serve a defence. If the defence is simply a defence, the

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claimant could immediately make an adjudication application. If the defence includes a cross claim and the claimant wishes to defend the cross claim, the claimant would have a prescribed period in which to lodge a response to the cross claim. It is suggested that this response be called a 'rejoinder'. In an adjudication, the parties would be limited to submissions in support of their respective ex–contractual claims, defence (including cross–claim, if any) and rejoinder. If the claimant does not make an adjudication application, the respondent would have the right to make an adjudication application in respect of the respondent's cross claim.

This simply mirrors the usual process of claim, defence, cross claim and rejoinder familiar to arbitrators and courts. The claimant is the equivalent of the plaintiff in litigation and the respondent is the equivalent of the defendant. The adjudicator could decide that either party is indebted to the other. The adjudicated amount would have to be paid within a prescribed period. Otherwise, the successful party would be entitled to apply for an adjudication certificate and register it as a judgment. The amount paid would be a payment on account and in other proceedings it could be decided that the amount must be repaid with interest.

Here is an example of the dual process. Assume that a purchaser claims that at 30 June 2007 the supplier is late in achieving practical completion and liable for $10,000 for liquidated damages. The purchaser [now the claimant] can make an ex–contractual claim. The supplier [now the respondent to the ex–contractual claim] could make a cross claim for an amount that the supplier claims is then due. The cross claim could be for a progress payment that is already overdue but not for a progress claim. That is a different matter. A progress claim could not be a defence because it is a claim for an amount which becomes due after the claim is made. The supplier could only set off an amount due from the purchaser to the supplier at the date upon which the defence is made.

Assume that the respondent's defence is simply that the claimant is not entitled to any liquidated damages. Assume that the defence is served within 10 business days. The claimant can make an adjudication application immediately. The adjudicator would have a prescribed time to make a decision on the issue. Assume that the adjudicator decides on 31 July 2007 that the claimant [purchaser] is entitled to $10,000. Assume that on 1 August 2007 the supplier makes a progress claim for $50,000. The supplier would have to pay the purchaser the $10,000 within the time allowed by the Act or it would be set off against the amount of the progress payment. The progress claim would be decided by an adjudicator in the usual way but the adjudicator would not be able to override the previous adjudicator's decision on the $10,000.

Ex–contractual claims should be confined to debts due under or for damages for breach of the construction contract and arguments over bank guarantees or similar securities. It would not be appropriate to bring in claims under the Trade Practices Act or claims in tort. Special consideration should be given to whether claims in restitution based upon a failed contract should be included in ex–contractual claims. In Pavey & Matthews v Paul (1986) 162 CLR 221 the High Court held that, in the absence of an enforceable contract, a builder could recover

the value of construction work in an action based upon unjust enrichment. One possibility is to allow claims in restitution in commercial contracts but not in the case of domestic building contracts.

Adjudication of a progress claim is essentially an exercise in valuing work and deciding whether work is defective or incomplete. It is a certification process. Adjudication of an ex–contractual claim and cross claim is likely to involve many more issues both of liability and quantum. It is a quasi judicial process. Consequently, an adjudicator deciding an ex–contractual claim is more likely to call for further submissions or hold a conference or make an inspection. It is proposed that an adjudicator deciding an ex–contractual claim should have a limited power to extend the time for making his or her decision.

It is also proposed that with the consent of all parties and the adjudicator, adjudications should be able to be consolidated. This could be particularly useful when a subcontractor is making a claim against the head contractor who, in turn, is making a similar claim against the principal or vice versa. Adjudications of progress claims and ex–contractual claims between the same parties could also be consolidated.

## BANK GUARANTEES

It is important that any amendment allows a claimant to make by way of an ex–contractual claim a claim for release of a bank guarantee or portion thereof. The construction contract should provide when the bank guarantee is due for release. Assume that it is 28 days after the end of the defects liability period and the guarantee is for $15,000. If the purchaser wants to claim an entitlement to call up the bank guarantee on account of defective work for which the purchaser claims $25,000, the purchaser should make an ex–contractual claim for $25,000 and have that adjudicated before the time for release of the bank guarantee. Alternatively, the purchaser could serve a defence to the claim for release of the bank guarantee. If the adjudicator decides that the purchaser is only entitled to $5,000, the adjudicator could decide that the purchaser must release $10,000 of the amount of the guarantee. A guarantee can be released in part.

There is need for legislation to bar the calling up of a bank guarantee before there is a final decision or a decision in adjudication that there is a debt against which the proceeds of the bank guarantee can be applied.

## ISSUE ESTOPPEL

The term 'issue estoppel' is well known in litigation. It is a doctrine to prevent the re–arguing of issues that have already been decided in court or arbitration. To prevent 'adjudicator shopping' and a multiplicity of adjudications, a limited form of issue estoppel is required for adjudication. A previous adjudicator's decision on liability as well as quantum should not be overruled in a subsequent adjudication decision [contrary to John Goss Projects v Leighton [2006] NSWSC 798].

For example, if in an adjudication of an ex–contractual claim the adjudicator has decided that the claimant is not entitled to liquidated damages because time has been set at large, a subsequent adjudicator should not decide otherwise. If one adjudicator has decided that the claimant is entitled to an extension of time thereby making the date for practical completion a particular date, a subsequent adjudicator should not be able to 'take away' that extension of time.

In litigation and arbitration the principle of issue estoppel is a bar to making further claims. In adjudication, the principle should be limited to making further claims in respect of entitlements that were decided in the adjudication of an earlier claim.

This would avoid a problem that arose recently in Queensland (in ACN 060 559 971 Pty Ltd v O'Brien [2007] QSC 91) where each progress claim by the contractor was met with the same reasons for withholding payment, namely a claim for liquidated damages and a claim for defective work. Each adjudicator in turn had to re–decide the same issues that had been decided by the preceding adjudicator. Under the proposed dual process, when the first adjudicator decides that at a certain date the respondent was not entitled to liquidated damages or an amount for defective work, the respondent would not be able to again claim those same amounts. However, the respondent could make a claim for liquidated damages allegedly accruing later or for damages for other defective work.

## SUMMARY

The dual process would require legislation. It would provide for progress claims, payment schedules, liability in the absence of a payment schedule, and adjudication just as now occurs in NSW, Queensland and Victoria. These are the States which have the certification process for adjudication.

The dual process would also provide that either party to a construction contract can make an ex–contractual claim. That is a claim for amounts allegedly already due as a debt or damages under or for breach of the construction contract. That is the traditional process that exists in NZ, WA, NT and, with some important differences, the UK.

An ex–contractual claim would be adjudicated similarly to progress claim but with a different timetable and allowance for a cross claims and a rejoinder.

A progress claim could only be made on or from a reference date by a supplier, i.e. the party to a construction contract who contracts to supply work, goods or services to another person, the purchaser. An ex–contractual claim could be made at any time by either party.

The essence of the dual process is that a supplier should be able to recover progress payments for the value (taking into account defects) of work goods or services actually supplied without deduction of amounts for cross claims which have not yet been quantified in adjudication or in final proceedings. Absent defective work, the only reason that a purchaser could have for not paying the unpaid value of work, goods or services the benefit of which the purchaser has received, is that the purchaser is entitled to set off an amount already determined to be due from the supplier to the purchaser.

In the Appendix, there are a number of examples of how the dual process would work in practice.

## APPENDIX

These are examples of how the dual process would work in a variety of different situations. In the examples, differences from the certification process are indicated. The 'purchaser' is the party for whom the construction work is carried out or to whom the related goods and services are provided. The 'supplier' is the party carrying out the work or supplying the related goods or services. The 'claimant' is the party making a progress claim or an ex–contractual claim. A purchaser or a supplier could be a claimant in an ex–contractual claim. The respondent is the party against whom a claim is made.

Examples:

1. Progress claim and no payment schedule.

2. Payment schedule disputes value of work.

3. Payment schedule asserts that progress claim includes amounts that cannot be included in a progress claim.

4. Payment schedule asserts that claim is barred.

5. Payment schedule includes 'back charges'.

6. Supplier claims delay costs.

7. Other claims by purchaser.

8. Election between a progress claim and an ex–contractual claim.

### 1. Progress claim and no payment schedule

This situation is very common. The supplier claims an amount as a progress payment or a final payment or for return of retention. If the purchaser fails to provide a payment schedule within 10 business days the supplier can apply to a court for summary judgment for the claimed amount [e.g. Walter Construction Group v CPL (Surry Hills) [2003] NSWSC 266] or elect to go to adjudication and give the purchaser another opportunity to provide a payment schedule.

Assuming that the supplier elects to go to adjudication and no payment schedule is provided within time, the adjudicator would decide the amount of the progress payment in the usual way.

The difference under the dual process would be that if the progress claim included a claim for damages, the adjudicator would not include damages in the amount of the progress payment. Similarly, if the supplier applied to a court for summary judgment without an adjudication, the court could refuse to enter summary judgment if the purchaser could show that the progress claim was not just a progress claim but included a claim for damages. This would avoid the situation that occurred in the Walter Construction case where the claimant recovered a summary judgment which included amounts which could not properly be included in a progress claim.

It seems that in the majority of cases where there is no payment schedule suppliers opt for adjudication rather than summary judgment. Consequently, the change which the dual process would make would have minimal impact. At the time of the Walter Construction case, the option to apply for adjudication rather than summary judgment did not exist.

### 2. Payment schedule disputes value of work

In many instances, the purchaser's only reason for withholding payment is that the work does not have the value claimed [i.e. the supplier has overvalued it having regard to the contract price and the extent of work carried out at the reference date] or that there is defective work and the purchaser is entitled to have the estimated cost of rectifying defective work taken into account in calculating the amount of the progress payment.

In this situation there would be no difference between the dual process and the certification process.

### 3. Payment schedule asserts that payment claim includes amounts that cannot be included in a progress payment

Sometimes in a payment schedule the purchaser asserts that under the terms of the construction contract or the

legislation the supplier is not entitled to a progress payment on account of some or all of the amount claimed because the claim (or part) is for damages or for extras (particularly delay costs) for which there is no entitlement or the entitlement is barred. Classic examples include Minister for Commerce v Contrax Plumbing [2005] NSWCA 142, Coordinated Construction v Hargreaves [2005] NSWCA 228 and Coordinated Construction v Climatech [2005] NSWCA 229.

This situation is common. Under the certification process it has given rise to the most problems and the most contentious litigation. It is the problem which the Victorian 2006 amendment attempts to avoid by creating the concept of 'excluded amounts'. The term 'ambush claim' has been used to describe claims for damages and delay that are included in progress claims. It is this situation which has generated the most criticism of the certification process.

Under the dual process the entitlement to a progress payment would be confined to a claim for the value of work actually carried out and goods and services actually provided. If, in the payment schedule, the purchaser identifies other claims, then in the calculation of the progress payment due the adjudicator would not include any amount for these claims.

The supplier could pursue by way of an ex–contractual claim the delay claims or other damages claims which cannot be made in a progress claim.

## 4. Payment schedule asserts that a claim is barred

In a payment schedule, the purchaser often relies upon a time bar clause or other clause in a contract to bar an entitlement. Separately, I have recommended that, in a contract of adhesion, unfair time bar or other barring clauses be rendered void just as 'pay when paid' clauses have been rendered void in each of the Acts referred to above.

However, assuming that such a barring clause is valid, then under the dual process the situation would be no different to that now existing under both the certification process and the traditional process. An entitlement could be barred by a time bar clause or other barring clause that did not contravene the 'no contracting out' provisions of the Act.

Often a contract provides that an entitlement is conditional upon the issue of a direction or approval by the superintendent or the purchaser and, in the absence of a direction or approval the claim is barred. Where there is such a direction or approval and the contract provides then for additional recompense to the supplier, the additional recompense is part of the contract price and can be the subject of a progress claim.

For example, the contract might provide that if the superintendent directs a variation, the supplier will be paid a reasonable extra amount. The supplier's claim for the reasonable extra amount would be a claim for part of the contract price. It could be the subject of a progress claim.

However, if there was no direction, then the supplier's claim would be a claim that there should have been a direction and the failure of the purchaser to give the direction or to ensure that the superintendent gave the direction is a breach of contract. The supplier would make an ex–contractual claim for the amount that the supplier would have received but for the breach of contract.

Sometimes an entitlement is not to a specified extra amount or a reasonable amount but only to the amount decided by the superintendent. If the superintendent decides that the supplier is entitled to an extra amount of, say, $10,000, then that amount could be included in a progress claim. If the supplier considers that the purchaser is in breach of contract because the amount should have been $15,000, the supplier could claim the extra $5,000 in a separate ex–contractual claim. Alternatively, the supplier could make a progress claim for the whole $15,000.

A claim for a progress payment and a claim for damages for breach of contract are quite different claims. As a progress payment, the claimant would be entitled to $15,0000 being the value of the variation. In a claim for breach of contract the claimant could recover more. The extra could be interest or Hungerfords damages [see Chapter 6.05 of my book Construction Claims, 2nd ed. 2006 Federation Press]. It is conceivable that in certain cases there could be other damages, even an entitlement to terminate the contract.

So that the determination of the amount of a progress payment can be decided quickly, the adjudicator of the progress claim only has to be satisfied that the extra work was directed and the value is either fixed by rates or prices in the contract or the mechanism provided by the contract, e.g. the certification by the superintendent. If the contract provides that the amount is to be a reasonable amount then that is a price fixed by the contract. The adjudicator can decide what is a reasonable amount. If the contract provides that the amount is the value decided by the superintendent and a progress

... in an adjudication of a progress claim, the adjudicator would not decide any cross claims but would decide issues about the value of work, goods and services, defects and the estimated cost of rectifying defects.

claim is made, the adjudicator can decide the amount to be included in the progress payment and is not required to give the work the same value as the superintendent gave it.

If the adjudicator of the progress claim is satisfied that the purchaser or superintendent did not give a written direction to do the additional work, and the contract provides that in the absence of a written direction the claimant is not entitled to be paid extra, that adjudicator would not include an amount for the additional work in the progress payment.

The supplier could make an ex–contractual claim at any time after the purchaser or superintendent fails or refuses to fulfil the contractual obligation to direct a variation. The fact that an amount cannot be included in a progress payment does not mean that the supplier is not entitled to damages and interest. Under the certification process, legislation presently imposes a time limit on making progress claims. There is no reason for a similar time limit on ex–contractual claims.

## 5. Payment schedule includes 'back charges'

It is common for a purchaser to withhold payment on account of alleged set offs for 'back charges'. These are claims by the purchaser that the supplier is liable to the purchaser for liquidated damages or other damages. The alleged damages may include the cost incurred by the purchaser in allegedly rectifying defective or unfinished work. They may include alleged damages consequent upon termination of the contract before completion. They may even include debts allegedly owed under another contract or set offs on account of claims by a third party against the purchaser. What these back charges have in common is that they are all for amounts for which liability or quantum or both have yet to be finally decided by a court, tribunal or arbitrator or under a dispute resolution provision of the construction contract.

Where, in a certification process, the amount of a progress payment is to be calculated under the terms of the Act [e.g. s9(b) of the Building and Construction Industry Security of Payment Act 1999 NSW] the purchaser is not entitled to set off claims for back charges. The problem of deciding a set off claim for back charges only arises where the construction contract has a provision for set off against progress payments of amounts claimed by the purchaser.

There are differences in the approach taken by adjudicators. Some take the approach that only a debt (owed to the purchaser) that is admitted by the supplier or has been decided by a court or tribunal or in arbitration or has been created under a dispute resolution clause in the contract, can be set off against progress payments. They take the view that an amount is only 'due' to the purchaser if the supplier admits that it is due or it has been decided in other proceedings that it is due. Other adjudicators decide disputed issues of liability for and quantum of the back charges. Sometimes this involves deciding what extensions of time the supplier was entitled to and whether the superintendent acted fairly. The problem is illustrated by John Holland v RTA [2007] NSWCA 19. Some adjudicators allow a set off of an amount claimed by the purchaser even if liability and quantum have not been proven.

A criticism of the certification process is that that fast track system was designed for calculating the amount of a progress payment and was

not intended to cover the more difficult task of deciding damages claims. It was not designed for deciding claims for extensions of time or for deciding whether breaches of contract had occurred and, if so, the quantum of damages. On the other hand, the traditional process was designed for that purpose. That is the reason for creating a dual process.

Under the dual process, the purchaser would not be able to raise a back charge as a reason for withholding payment of a progress payment unless liability for and the quantum of the purchaser's entitlement had been admitted by the supplier or had already been decided in an adjudication of an ex–contractual claim or had finally been decided in other proceedings.

This would simplify adjudication of a progress claim yet allow a purchaser a right to pursue claims against the supplier in adjudication of an ex–contractual claim. Immediately a party to a construction contract considers that the other party has breached the construction contract, that party can make an ex–contractual claim against the other party. The other party has an equal right to respond with a cross claim. This is the traditional process. It is a fair process. The shortcoming in the traditional process is that it does not provide a fast track process for recovery of a progress payment. The dual process combines the advantages of both the traditional process and the certification process.

Frequently, it is only when the supplier makes the final payment claim that the respondent raises 'back charges'. Under the dual process, if by the time for making a progress claim [a reference date] the supplier has not received an ex–contractual claim from the purchaser, the supplier can expect to be paid the progress payment without a set off. The purchaser will nevertheless be able to pursue an ex–contractual claim and, if successful, the purchaser will be entitled to payment or repayment by the supplier of the adjudicated amount of the ex–contractual claim.

The timing of payments is most important. A delayed progress payment can have serious implications for a supplier. The timing of payments is dependent upon the time when the amount due is ascertained. If the supplier delays making a claim, the purchaser may be insolvent by the time the supplier is in a position to enforce payment. That is the reason for compulsory rapid adjudication. It enables the amount due to be decided quickly so that payment can be enforced.

Purchasers will argue that under the dual process they may have to pay a progress payment even though they have a claim of set off. A mere claim to a set off is not a reason for withholding a progress payment. The amount of the set off must first be decided by agreement or in adjudication or in other proceedings before the set off can be made. If a purchaser wants the amount of a set off to be decided in adjudication the purchaser can make an ex–contractual claim against the supplier at any time. If the purchaser delays making the claim until the purchaser receives the supplier's final claim, the purchaser might have to pay, by way of a progress payment, the amount of the final claim before the amount of the set off is decided. If the supplier then becomes insolvent, the purchaser might be unable to recoup the amount of the set off.

Purchasers may ask, 'Why can't liability and quantum of a claim of set off be decided in the adjudication of a progress claim?' The reason is that adjudication of a progress claim is a fast track process that is not suitable for deciding issues of breach of contract, extensions of time, repudiation and termination, causation, quantification of damages, etc. Those issues are better dealt with in an adjudication which allows defences, cross claims, rejoinder and more time for deciding the many issues that may arise. Under the dual process, the supplier is similarly prevented from making claims of breach of contract in the adjudication of a progress claim.

One of the most common claims of set off made by purchasers is a claim to liquidated damages for delay in achieving practical completion. If a purchaser was to be given the right to have issues of delay and extensions of time decided by the adjudicator in the course of adjudicating a progress claim, then a supplier would have to have the same right to have claims for delay costs decided in the adjudication. This would allow suppliers to include claims for damages, in particular delay costs, in progress claims. There would then be no dual process.

To summarise, in an adjudication of a progress claim, the adjudicator would not decide any cross claims but would decide issues about the value of work, goods and services, defects and the estimated cost of rectifying defects. But if in another adjudication or other proceedings it has been decided that the purchaser is entitled to make a set off of a particular amount, that set off would be made against the progress payment.

## 6. Supplier claims delay costs

In larger construction contracts, the supplier frequently claims that the purchaser delayed the supplier and the supplier is

entitled to delay costs. There are two types of delay cost claims.

One is where the contract provides for payment by the purchaser of delay costs. There may be a clause that provides that for every day of delay for which the superintendent grants an extension of time [EOT], the purchaser will pay the supplier, say, $1,000. If the superintendent grants an EOT of 9 days then $9,000 is automatically added to the contract price and can be claimed in a progress claim.

Often the supplier claims that the superintendent should have but failed to grant an EOT. Then the supplier's claim is for damages for breach of contract. That would be made by an ex–contractual claim. The adjudicator would have to decide whether the purchaser was in breach of contract and, if so, what EOT should have been granted and what amount the supplier would have received had the purchaser not breached the contract.

The second type of delay cost claim is simply a claim for damages for breach of contract. It may be based upon many different types of alleged breach. For example, failure to provide possession or access, failure to provide co–ordination, defects in design, excessive variations, delays in responding to requests for information, etc. Under the dual process, that claim for delay costs could not legitimately be included in a progress claim. At any time the supplier could make an ex–contractual claim for delay costs allegedly due up to the date of the ex–contractual claim. The other party could raise a defence or cross claim or both. The supplier could concurrently make a progress claim and an ex–contractual claim but only the latter could include a claim for delay costs. There is no necessity for the claims to be decided by the same adjudicator or at the same time. However if the adjudication applications are made to the same authorised nominating authority the same adjudicator may be appointed to decide both applications.

At present, delay cost claims tend to be made as an ambit claim at the end of a project. This is because, as arbitration and litigation work, a party is effectively forced to leave all claims for damages until the end of the project. The right to have each claim for delay costs adjudicated immediately after the delay occurs would avoid the need for an ambit claim. Given this right, a clause in the contract could effectively and not unfairly bar the ambit claim for delay costs.

## 7. Other claims by purchaser

Sometimes work is defective but it would not be reasonable and necessary to rectify the defect. Ruxley Electronics v Forsyth [1993] 1 WLR 650 is a classic case. In that instance, although the work is defective, there is no entitlement to the estimated costs of rectification and no economic loss. That is a case where the claimant purchaser could make an ex–contractual claim [see Chapter 10 of my book Construction Claims, 2nd ed. 2006 Federation Press]. Related is a claim for mental distress. This would be a rare instance and would only be relevant to domestic premises. See Chapter 12.05 of the book.

## 8. Election between a progress claim and an ex–contractual claim

In rare instances, the supplier may have a choice of pursuing a progress claim or an ex–contractual claim against the purchaser. For example, if at the end of, say, June, a progress payment certified by the superintendent is not paid on the due date, the supplier could opt to make an ex–contractual claim for the amount overdue and interest. This would not be a progress claim under the Act. It would be a claim for a debt. Alternatively, the supplier may decide to make a progress claim under the Act. The amount payable as a progress payment would then be decided by the adjudicator. It might not be the same as the amount decided by the superintendent. Once an adjudicator has decided the progress payment due at the end of June, any subsequent adjudicator would not be able to decide a different the amount. Consequently, there is no point in the supplier making both a progress claim and an ex–contractual claim for the same progress payment.