

Construction Law Article: The Issue of Set-off - Simply no one size fits all

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Commercial and Construction

5TH JUN
2023

Construction

First published in Construction Law Magazine on 5 June 2023.

Everyone loves a trier and parties have been trying to find ways to set-off one claim against another with varying degrees of success and, mostly, failure. The recent case of *FK Construction v ISG Retail Limited* [2023] EWHC 1042 (TCC) is no exception. The point of interest is why in that case and others the attempted set-off failed.

Generally, set-offs – as with any other devices designed to frustrate the enforceability of an adjudicator's decision in a statutory adjudication do not fair well as a defence to proceedings to enforce the decision.

If there is a general rule applicable to claims to set-off one adjudicator's decision against another, it is that a party who has lost an adjudication brought under the aegis of the Housing Grants, Construction and Regeneration Act 1996 (as amended) ("the Act"), cannot set off a claim for loss or damages which was not considered by the Adjudicator in the adjudication. There are a number of cases which support this proposition and most of the results are entirely predictable.

An early case is the Scottish Outer House's judgment in *Allied London & Scottish Properties PLC v Riverbrae Construction Limited* [1999] BLR 246. Here the result fits the "entirely predictable" mould, and although now 24 years ago, the decision would be the same today. The Adjudicator decided that sums were due from the Petitioner to the Respondent, the Adjudicator rejected a claim to retain the sums he found to be due against sums claimed by the Respondent from the Petitioner on other contracts, alternatively the Respondent's application to have them put on deposit while the other claims were pursued. The Adjudicator, and then the Court rejected the set off, the application to have them put on deposit being simply another way of sustaining the retention claim which the Adjudicator had specifically rejected.

In *VHE Construction Plc v RBSTB Trust Co. Ltd* [2000] BLR 187 (TCC), the Court rejected the employer's attempt to refuse payment of the majority of an Adjudicator's decision in favour of the contractor by setting off its claim for liquidated damages ("LDs") for delay. The employer had not served any withholding notice, which the court found to be a necessary precondition to withholding payment stating: "*The words "may not withhold payment" [a reference to s111 of the Act] are in my view ample in width to have the effect of excluding set-offs...*". The court also rejected the argument that the employer retained any "residual right" to set off its liquidated damages claim which "residual right" did not exist. It held that "*...section 11 now constitutes a comprehensive code governing the right to set off against payments contractually due.*"

The court's decision was rooted in the fundamental principles settling by earlier decisions confirming that the intention of Parliament in enacting the Act was that adjudicators' decisions were binding and should be enforced pending [any] final determination by arbitration, litigation or agreement. He found that the

obligation to comply with the Adjudicator's decision meant that the losing party must do so without recourse to defences or cross claims not raised in the adjudication.

The leading case on this issue is now [still] the decision of the Court of Appeal in ***Ferson Contractors Limited v Levulus A T Limited*** [2003] EWCA Civ. 11. The appeal was from a judgment of the TCC enforcing an adjudicator's decision. The case arose out of a sub-contract containing an adjudication agreement which complied with the mandatory provisions of s108 of the Act. Under the sub-contract Levolux claimed payment for work done and when served with a notice of withholding in respect of the majority of its claim, suspended performance. Ferson responded with a notice to Levolux to recommence work failing which it would determine the contract. Levolux responded by issuing a notice of adjudication. Ferson subsequently purported to determine the contract.

The Adjudicator found substantially in favour of Levolux and ordered payment within 7 days of his decision. Ferson did not pay and Levolux issued enforcement proceedings. By way of defence, amongst other matters, Ferson relied on an entitlement to terminate which would give rise to a right under the sub-contract not to pay any sums due or accruing due. The TCC judge held that it was implicit in the Adjudicator's decision that Levolux was entitled to suspend performance and therefore a purported termination based on a wrongful suspension of work had no contractual effect.

On appeal, the Court of Appeal agreed with the TCC's interpretation of the Adjudicator's decision and, after reviewing recent authorities which may have given rise to an assumption that in the face of clear contractual terms, or a contrary adjudication decision giving rise to a right of deduction or cross claim against the sum ordered by the Adjudicator, the earlier decision with either not be enforced or the judgment stayed. The Court of Appeal distinguished the earlier cases but equally rejected any broad statement of principle to such an effect and decided that the intention of s108 of the Act was clear and a contract must be construed so as to give effect to it. If that intention could not be construed from the contract then the offending clause must be struck down.

Subsequent cases have followed the ***Ferson v Levolux*** case. In relation to cross claims for LDs, the authorities were revisited in the case of ***Balfour Beatty Construction Ltd v Serco Ltd*** [2004] EWHC 3336 (TCC). Jackson J derived two principles of law:

- a. Where it follows logically from an adjudicator's decision that the employer is entitled to recover a specific sum by way of LDs, then the employer may set off that sum against monies payment to the contractor pursuant to the adjudicator's decision, provided that the employer has given proper notice (in so far as required).
- b. Where the entitlement to LDs has not been determined either expressly or impliedly by the adjudicator's decision, then the question whether the employer is entitled to set-off LDs against sums awarded by the adjudicator will depend upon the terms of the contract and the circumstances of the case.

Sir Peter Coulson LJ, in *Construction Adjudication*, Fourth Edition, suggests a third principle:

- c. *"If it is to be said that the terms of the contract as to set-off are to override the effect of the adjudicator's decision, and deprive the successful party in the adjudication of the sum otherwise due pursuant to the adjudicator's decision, then those terms must clearly provide for such an outcome."*

In each case, I would respectfully suggest that while such arguments are available in principle, they should be pursued only by losing parties in adjudication who have money to burn and/or everything to lose.

As to parties asserting a cross claim or set-off which has not been adjudicated upon at the time of enforcement, these and later cases indicate that it will fail. Enforcement proceedings and any interpartes reckoning is generally decided on the basis of parties' current rights and obligations as they stand at the end of each adjudication: see ***Interserve Industrial Services Ltd v Cleveland Bridge UK Ltd*** [2006] EWHC 741 (TCC); or *"...the claiming party is entitled to receive the payment it should have received at the date of the interim payment without taking into account subsequent events or other claims for set-off."* ***Ledwood Mechanical Engineering Ltd v Whessoe Oil and Gas Ltd and Another*** [2007] EWHC 2743 (TCC). As to cases which have proved to be exceptions to the general rule, these have broadly

either been founded on the proper construction of the terms of the parties' contract, or the proper interpretation of the adjudicator's decision.

The case of *HS Works Limited v Enterprise Managed Services Limited* [2009] EWHC 729 (TCC) involved disputes about the evaluation of HS's final account and a number of contra charges claimed by Enterprise. There were two adjudications, the first determined that £1,835,252.26 was due to HS, the second found that the proper value of the subcontract works was £23,253,931.09 after allowing for contra charges which meant that all or part of the sum awarded in the first adjudication should be repaid if paid at all. Both parties sought to enforce the decision which was in its favour arguing that the decision adverse to its interest was invalid on ground of jurisdiction or [breach of] natural justice. The applications were heard together by the Court.

The challenges in both adjudications were rejected, each was held to be valid and the judge ordered enforcement of both decisions. The effect was that FK was entitled to a payment as at 12 February 2009 but from 16 March 2009, ISG was entitled to the return of the money overpaid.

The Court set out the following steps which it said should be considered before deciding whether to permit a set-off of one decision against another:

"a. First, it is necessary to determine at the time when the Court is considering the issue whether both decisions are valid, if not, or it cannot be determined whether each is valid, it is unnecessary to consider the next steps.

b. If both are valid, it is then necessary to consider if, both are capable of being enforced or given effect to; if one or other is not so capable, the question of set off does not arise.

c. if it is clear that both are so capable, the Court should enforce or give effect to them both, provided that separate proceedings have been brought by each party to enforce each decision. The Court has no reason to favour one side or the other if each has a valid and enforceable decision in its favour.

d. How each decision is enforced is a matter for the Court. It may be wholly inappropriate to permit a set off of a second financial decision as such in circumstances where the first decision was predicated upon a basis that there could be no set off." [Judgment of Akenhead J, para. 40]

In the event, the Court exercised its discretion as to how any order or orders on judgment should be drawn and decided to make orders reflecting the net position between the parties consequent on its judgment.

Turning to the very recent case of *FK Construction Limited v ISG Retail Limited* [2023] EWHC 1042 (TCC) what was the issue there? FK was a roofing and cladding sub-contractor to ISG, on a bespoke ISG sub-contract on a project in Bristol known as Project Barberrry. The sub-contract incorporated the Statutory Scheme for adjudication with litigation in the English courts as the forum for the final determination of disputes. FK referred an unpaid application for interim payment which was the subject to a purported payless notice ("PLN") from ISG to adjudication. The Adjudicator found in favour of FK and directed ISG to pay £1,691,679.94 plus VAT and interest on the basis that ISG's PLN was out of time and invalid ("the Wood decision"). ISG did not pay and FK issued proceedings to enforce the decision net of VAT which FK accepted was not applicable. There were two earlier adjudications and one later decision ("the Molloy decision") issued after commencement of the enforcement proceedings, all in favour of FK but the last decided that FK was owed a lesser sum of £906,738.20. One of the earlier decisions was subject to a pending hearing of a Part 8 application issued by ISG.

The same parties were also engaged on another project known as Project Triathlon in respect of which there had been three decisions, two in favour of ISG and one in favour of FK. FK intimated its intention to challenge by way of Part 8 proceedings one of the decisions in favour of ISG which was to be heard with the Barberrry Part 8 proceedings. The net effect of the Triathlon decisions was that FK owed ISG £66,620.68.

ISG's sole defence to enforcement of the Wood decision was based solely on its claim to have a valid set-off which the court should take into account. The Court reviewed the authorities on set-off, the most important of which are considered above. ISG relied on one of the limited exceptions to the rule against set-

off which was considered in the cases of *HS v Enterprise and JPA Design and Build Limited v Sentosa (UK) [2009] EWHC 2312 (TCC)* where there are two valid and enforceable decisions involving the same parties whose effect is that monies are owed by each party to the other.

In *FK v ISG* the court noted that in *HS v Enterprise* and the *Sentosa* case the courts were dealing with the two decisions simultaneously. *Sentosa* case also concerned a decision where LDs had been awarded by the Adjudicator and so fell within one of the exceptions noted by Jackson J in the *Balfour Beatty* case.

ISG sought to avoid making an overpayment by arguing for enforcement of the Wood decision only up to the value of the Molloy decision and also by setting off the net effect of the Triathlon decision, namely a further £66,620.68. However, after considering the authorities, and working through the steps set out by Akenhead J in the *HS v Enterprise* case, the Court declined to permit any set off.

In the case of the Molloy decision recently issued, the Court had not been asked to determine its validity and could not do so in the instant proceedings where it was concerned only with the enforcement of the Wood decision. Effectively therefore ISG's defence failed at the first of Akenhead J's steps. On the second step, the Judge repeated the point about its inability to determine the enforceability of the Molloy decision and added that it could not give effect to a decision that was not yet enforceable. The application to set-off the Triathlon decisions was rejected for similar reasons. The Judge also noted that the suggestion that a decision in relation to one project could be set-off against another was entirely novel and the ISG contract term permitting such a cross project set-off potentially offended the statutory requirement for immediate enforcement of an adjudicator's decision.

The court also noted that it was not, as in *HS v Enterprise* or the *Sentosa* case, dealing with two decisions which were the subject of separate proceedings which were heard by the court at the same time so as to enable it to determine the enforceability of each of the decisions.

By way of conclusion, the court went on to state that it was important that parties are not encouraged to raise arguments over potential set-off and withholding as a means of seeking to defeat (or mitigate the effects of) otherwise legitimate enforcement proceedings save in the very limited circumstances identified in the exceptions referred to. By way of conclusion to this article, it is tolerably clear that the applications for set-off advanced in most if not all these cases were designed to do just that.

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