MC MS Blog

Defences to true value claims – does any uncertainty remain?

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I was lucky enough to travel to Hong Kong last week and speak at this year's Society of Construction Law Hong Kong International Conference. Hong Kong is making great progress with its Security of Payment legislation, and I was asked to speak on various aspects of it, including some of the proposed adjudication provisions.

The Bill is a whopping 90 pages long, and so you won't be surprised to hear that it's somewhat prescriptive. I won't go into the ins and outs of it in this blog (we'll save that until the Bill is settled and becomes law), but studying the parts concerning the defences to payment claims which can be raised in an adjudication got me thinking about this topic in respect of true value claims in the UK, as I had been reading the various commentaries in the case of *Morganstone Ltd v Birkemp Ltd* **[2024] EWHC 933 (TCC)**. This case appears to put to bed the question of whether an adjudicator has jurisdiction to consider set-off defences raised for the first time in a true value adjudication, confirming that they do. However, I think that it is at least arguable that there are some unanswered questions. Let me explain.

Morganstone v Birkemp

I appreciate that the judgment was handed down in April, and I am by no means the first person to comment on it. However, I thought it would be useful for me to set out some of the background.

In December 2021, Morganstone Ltd ("Morganstone"), the main contractor, entered into a subcontract with Birkemp Ltd ("Birkemp"), the civil engineering sub-contractor, to provide groundworks at a housing development in Swansea (the "Subcontract"). On 31 August 2023, Birkemp issued an interim payment application (the "August Application"), to which Morganstone contended that Birkemp had no entitlement to issue further interim payment applications due to the schedule of payment dates expiring. Without prejudice to that position, Morganstone issued a pay less notice. In December 2023, Birkemp referred a dispute to adjudication regarding certain alleged 'Inappropriate Deductions' in Morganstone's pay less notice (which Birkemp evidently accepted was valid). The adjudicator found that the August Application was valid, that Morganstone had made various unlawful deductions, and that Birkemp was entitled to the sum of £207,076.

After Morganstone didn't pay the sum found due by the adjudicator, the subsequent case in the TCC concerned two linked claims:

1. a Part 7 claim by Birkemp to enforce the adjudicator's decision (the "Decision"); and
2. a Part 8 claim by Morganstone claiming Birkemp had no contractual right to make the August Application and no repayment was due. In the alternative, if Morganstone's Part 8 claim failed,

> Morganstone sought to defend Birkemp's Part 7 claim on the basis that the adjudicator breached the rules of natural justice by failing to consider defences put forward by Morganstone in the adjudication, and the award is therefore unenforceable.

I don't want to dwell on Morganstone's Part 8 claim as it's not really relevant to the subject of this blog, but suffice to say that HH Judge Keyser KC dismissed it, and held that Birkemp was entitled to continue to make interim applications in 2023, including the August Application.

The judge then went on to consider Morganstone's defence to enforcement, namely that the adjudicator had erroneously taken an overly restrictive view of his jurisdiction and had consequently breached the rules of natural justice. In Morganstone's Response in the adjudication, it relied on two cross-claims which weren't raised in the pay less notice. In particular, Morganstone argued that it was entitled to set off sums due to the later discovery of defects. In the Decision, the adjudicator accepted Birkemp's argument in its Reply which asserted that the cross-claims were outside the scope of the adjudication, and were therefore not taken into account in his overall award.

HH Judge Keyser KC helpfully cited O'Farrell J in *Global Switch Estates Ltd v Sudlows Ltd* **[2020] EWHC 4796 (TCC), [2021] BLR 111**, which **I blogged about at the time**. The judge reviewed the relevant cases and at paragraph 50 of her judgment she set out her observations:

> *"i) A referring party is entitled to define the dispute to be referred to adjudication by its notice of adjudication. In so defining it, the referring party is entitled to confine the dispute referred to specific parts of a wider dispute, such as the valuation of particular elements of work forming part of an application for interim payment.*
>
> *ii) A responding party is not entitled to widen the scope of the adjudication by adding further disputes arising out of the underlying contract (without the consent of the other party). It is, of course, open to a responding party to commence separate adjudication proceedings in respect of other disputed matters.*
>
> *iii) A responding party is entitled to raise any defences it considers properly arguable to rebut the claim made by the referring party. By so doing, the responding party is not widening the scope of the adjudication; it is engaging with and responding to the issues within the scope of the adjudication.*
>
> *iv) Where the referring party seeks a declaration as to the valuation of specific elements of the works, it is not open to the responding party to seek a declaration as to the valuation of other elements of the works.*
>
> *v) However, where the referring party seeks payment in respect of specific elements of the works, the responding party is entitled to rely on all available defences, including the valuation of other elements of the works, to establish that the referring party is not entitled to the payment claimed.*
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> *vi) It is a matter for the adjudicator to decide whether any defences put forward amount to a valid defence to the claim in law and on the facts.*
>
> *vii) If the adjudicator asks the relevant question, it is irrelevant whether the answer arrived at is right or wrong. The decision will be enforced.*
>
> *viii) If the adjudicator fails to consider whether the matters relied on by the responding party amount to a valid defence to the claim in law and on the facts, that may amount to a breach of the rules of natural justice.*
>
> *ix) Not every failure to consider relevant points will amount to a breach of natural justice. The*

breach must be material and a finding of breach will only be made in plain and obvious cases.

x) If there is a breach of the rules of natural justice and such breach is material, the decision will not be enforced."

HH Judge Keyser KC agreed with Morganstone that the adjudicator in this case had taken an overly restrictive view of his jurisdiction in not considering Morganstone's cross-claims. In particular, the judge stated at paragraph 61 and 62 that:

"61. As to the second submission, Birkemp was not merely seeking a ruling on the appropriate of specific deductions in the pay less notice. It was seeking, and it obtained, an award of payment. Whether or not Birkemp's drafting could fairly be characterised as "devious" (see the Pilon case at [26]), Birkemp's manner of drafting the Notice of Adjudication and its subsequent reliance on the confines of that drafting clearly sought to "put beyond the scope of the adjudication the defending party's otherwise legitimate defence to the claim"—that is, the claim for payment. Birkemp's tactic amounted to the use of a fallacious argument that, once the validity of the deductions in the pay less notice had been determined, it was entitled to payment of the resulting amount. Morganstone was not seeking to widen the scope of the adjudication by raising other, freestanding disputes. It was engaging with and responding to the issues in the adjudication by raising cross-claims as a defence of set-off to Birkemp's claim for payment.....

62. It follows that, in my judgment, the adjudicator took an erroneously restrictive view of his jurisdiction. The relevant considerations are, therefore, those in propositions (viii), (ix) and (x) in O'Farrell J's judgment in Global Switch and principles 2-5 in Coulson J's judgment in the Pilon case. In the present case, the adjudicator's failure was deliberate rather than inadvertent, in that he specifically addressed his mind to the question whether the cross-claims could be raised on the adjudication and decided that they could not be raised as they fell outside the scope of the adjudication. The error was material, in that the cross-claims would, if upheld, have had a very significant effect on the overall result of the adjudication. Moreover, the error was brought about by Birkemp's deliberate attempt to achieve a tactical advantage by confining the scope of the adjudication in such a manner as to exclude potentially relevant defences to the claim for payment."

The Court therefore found that the Decision was unenforceable due to having been made on the basis of an error as to the adjudicator's jurisdiction and in breach of the rules of natural justice.

My thoughts

Last month, I helped to moderate one of the CIArb's "Let's Discuss" sessions expertly led by Matt Drake. The topic was defences in adjudications and began with the following poll question:

"In adjudication proceedings where the referring party is seeking a payment, does an adjudicator have jurisdiction to consider a particular defence raised by the Responding Party where, even though a valid pay less notice was served, the particular defence now raised by the Responding Party was not itself included in the (valid) pay less notice? (Yes, No or Not Sure)"

Interestingly, when the poll was taken at the beginning of the event there was a roughly equal split between the 'yes' and 'no' camps, but by the time we'd worked through the exercise, including discussing cases such as *Global Switch v Sudlows and Morganstone v Birkemp,* the vast majority of those attending voted 'yes'. However, I cautioned that I don't think it's as simple as 'yes' or 'no', and that it might depend on the circumstances, including the type of defence raised. I say this because both *Global Switch v Sudlows* and *Morganstone v Birkemp* are cases where the referring parties intentionally attempted to narrowly restrict the scope of the dispute, and the defences raised both went to the true value of the referring parties' accounts.

However, let's imagine a slightly different scenario:

1. The contractor, Jack, issues its Interim Valuation 8 ("IV8") claiming payment of £500k;
2. The employer, Jill, issues a valid pay less notice disputing Jack's valuation of the variations, and she values Jack's entitlement in the sum of £300k, which she pays on time;
3. Jack decides to refer the true value of IV8 to adjudication. Although his submissions focus on the true value of the variations, he makes no attempt to narrow the scope of the dispute to exclude other aspects of IV8. Jack claims payment of £200k;
4. In her Response in the adjudication Jill maintains her valuation of the variations, but for the first time she submits that she's also entitled to cross-claim for damages of £100k due to Jack's culpable delays. As such, Jill argues that Jack's entitlement under IV8 was only £200k, and that she's therefore entitled to repayment of £100k.

The first important difference in this scenario is that Jack has not attempted to achieve a tactical advantage by confining the scope of the dispute referred. Such attempts were obviously a factor in the judge's findings in *Morganstone v Birkemp, w*hich is consistent with Coulson J's (as he was then) views in *Pilon Ltd v Breyer Group Plc* **[2010] EWHC 837 (TCC)** (refer to paragraph 22.5). The second important distinction to make is that Jill's further defence raised in the adjudication doesn't go to the true value of Jack's works, and instead it's a separate cross-claim for damages which had not been raised prior to the adjudication. This is unlike *Morganstone v Birkemp* where the judge accounted for the fact that Birkemp had not raised *"...other free-standing disputes...". T*he question which therefore arises is, does the adjudicator have jurisdiction to take account of Jill's damages claim? Some might argue not, as the free-standing cross-claim for delay damages was not set-out in the pay less notice. Then again, if the adjudicator doesn't have jurisdiction, then wouldn't this be contrary to the highest authority on this point, namely *Bresco Electrical Services Ltd (In Liquidation) v Michael J Lonsdale (Electrical) Ltd* **[2020] UKSC 25** in which Lord Briggs stated at paragraph 44:

> "*However narrowly the referring party chooses to [confine] the reference, a claim submitted to adjudication will nonetheless confer jurisdiction to determine everything which may be advanced against it by way of defence,* ***and this will necessarily include every cross-claim which amounts to (or is pleaded as) a set-off.***" [emphasis added]

But if the Supreme Court is right then doesn't this ride roughshod over pay less notice provisions of section 111 of the Construction Act and enable payers to raise defences to previous claims that could and should have been included in such notices?

Now do you see what I mean about potential uncertainty?

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