

CONSTRUCTION : BULLETIN

Can You Recover Adjudication Costs Under the Late Payment of Commercial Debts Act?

When the Late Payment of Commercial Debts (Interest) Act 1998 was amended by the Late Payment of Commercial Debts Regulations 2013, a new right to recover “the reasonable costs of recovering a debt” was introduced. Since then, there has been uncertainty about whether this new right might allow the recovery of legal and other costs incurred in an adjudication. This question has finally been addressed by the courts in the case of *Lulu Construction Ltd v Mulalley & Co Ltd*.

Recovery of costs under the Late Payment Act

The Late Payment of Commercial Debts (Interest) Act 1998, as amended by the Late Payment of Commercial Debts Regulations 2013 (the ‘Late Payment Act’), provides for the payment of statutory interest for late payment of debts in cases where a contract does not contain a substantial remedy for the late payment. Where statutory interest is payable, section 5A of the Late Payment Act provides that:

- once statutory interest begins to run, the payee is entitled to a fixed sum in addition to the statutory interest (section 5A(1));
- the fixed sum is £40 for a debt less than £1,000, £70 for a debt less than £10,000 and £100 for a debt in excess of £10,000 (section 5A(2)); and
- if the reasonable costs of the payee in recovering the debt are not met by the fixed sum, the payee is also entitled to a sum equivalent to the difference between the fixed sum and those costs (section 5A(2A)).

Background

Lulu was engaged as a sub-contractor by Mulalley. The parties were in dispute about sums due and Lulu submitted a claim alleging entitlement to be paid for variations worth about £1m. Mulalley started an adjudication to establish the value of Lulu’s claim. The adjudicator decided that Mulalley had to pay Lulu £240,324.77. Mulalley only paid £182,863.80. The outstanding balance consisted of “debt recovery costs” of £47,666.27 and interest accruing at the daily rate of £37.35. The adjudicator awarded both these remedies pursuant to the Late Payment Act. Mulalley accepted that it was required to pay the interest, but refused to pay the debt recovery costs on the basis that:

- the adjudicator did not have jurisdiction to award those costs because they were not part of the dispute referred to him; and
- it was not open to Lulu to raise the debt recovery costs as a defence in the adjudication.

Was the award of “debt recovery costs” enforceable?

It was not disputed that no claim for debt recovery costs pursuant to the Late Payment Act had been advanced in the Notice of Adjudication or the Referral Notice. The claim for debt recovery costs was not raised by Lulu until submission of their Rejoinder. However, given that Mulalley was the referring party, the court found that it was “hardly surprising” that debt recovery costs had not been sought in the Notice of Adjudication or Referral Notice. The court accepted that the claim for debt recovery costs was not part of the dispute referred to the adjudicator.



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The court then turned to consider whether Lulu was permitted to raise the debt recovery costs as a defence. The court referred to the 2009 case of *Allied P&L Ltd v Paradigm Housing Group Ltd*, in which it was held that it is open to a defendant to raise any defence to a claim which is referred to adjudication. Significantly, the court in that case stated:

“if the basic claim, assertion or position has been put forward by one party and the other disputes it, the dispute referred to adjudication will or may include claims for relief which are consequential upon and incidental to it and which enable the dispute, effectively, to be resolved. Thus, even if the claim did not as such seek a declaration or discretionary interest or costs, it is so connected with and ancillary to the referred dispute as properly to be considered as part of it.” (emphasis added)

Relying on this previous case, the court found that although the debt recovery costs claimed by Lulu (which were the costs of running the adjudication) were not within the scope of the dispute set out in the Notice of Adjudication and Referral Notice, they were “clearly connected with and ancillary to the referred dispute and must properly be considered part of it”. The adjudicator was therefore correct to conclude that he had jurisdiction to decide the debt recovery costs element of the dispute and Lulu was entitled to be paid its debt recovery costs in accordance with the adjudicator’s decision.

Implications of this case

This case is surprising because its main focus is on whether it was permissible to introduce the debt recovery costs claim as a defence during the course of the adjudication, not the wider question of whether or not the Late Payment Act actually permits the recovery of adjudication costs. Many practitioners consider there is a conflict between the right to recover reasonable debt recovery costs under section 5A(2A) of the Late Payment Act and the provisions of section 108A of the Housing Grants, Construction and Regeneration Act 1996, as amended by the Local Democracy, Economic

Development and Construction Act 2009 (the ‘Construction Act’).

Section 108A of the Construction Act provides that a contractual provision which concerns the allocation of adjudication costs is ineffective unless it is written into the contract and confers power on the adjudicator to allocate his fees and expenses between the parties. Section 108A is notoriously badly drafted and can be interpreted in two different ways, but the government has made it clear that section 108A is intended to prohibit “Tolent clauses” (which require one party to pay the other’s adjudication costs) and it is likely to be interpreted in this way if it ever comes before the courts.

Assuming that section 108A does require the parties to bear their own adjudication costs, there is an apparent conflict with the Late Payment Act which is not resolved by the court’s decision in this case. There does not seem to have been any argument between the parties about this potential conflict and the court appears to have simply accepted that the Late Payment Act applies to adjudication costs.

This case potentially has big implications for parties involved in adjudication because it opens the door for arguments about the recovery of costs. We may now see referring parties start to add on claims for debt recovery costs pursuant to section 5A of the Late Payment Act. However, it is important to remember that the Late Payment Act only applies in circumstances where the parties do not expressly include a substantial remedy for late payment in their contract. Many construction contracts (especially standard form contracts) already contain a rate of interest for late payment which provides a substantial remedy. For example, there have been a number of past court decisions which have upheld the 5% interest rate in JCT contracts as being a substantial remedy. It is disputes relating to oral or partly oral contracts, or written contracts which do not include an interest rate, which are most likely to involve claims for debt recovery costs. We anticipate that

there will also be a much greater incentive for contracting parties who have signed up to very low interest rates to start challenging those rates as not providing a substantial remedy so that they can bring the Late Payment Act into play and try to recover their costs. This emphasises the importance for paying parties of agreeing a reasonable contractual interest rate to protect against the risk of the Late Payment Act becoming applicable.

Finally, it is worth noting that the court in this case did not address whether the debt recovery costs were “reasonable”, as required by the Late Payment Act. Given that the costs had seemingly been assessed and awarded by the adjudicator, it is likely that Mulalley would only have been able to challenge the reasonableness of the costs by referring the matter to court for final determination. Nevertheless, it is worth bearing in mind that if you are involved in an adjudication and the other party claims costs under the Late Payment Act, there may be scope to defend the claim on the basis that the costs claimed are not reasonable.

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