JUDGMENT : Mr Justice Ramsey. TCC. 20th November 2007

Introduction

1. The Claimant, Ledwood Mechanical Engineering Limited ("Ledwood"), was engaged by the Defendants, Whessoe Oil and Gas Limited and Volker-Stevin Construction Europe BV ("the Joint Venture") to act as subcontractor for fabrication and erection of pipework at the Dragon liquid natural gas import terminal at Milford Haven.

The Proceedings

2. These Part 8 proceedings arise out of a dispute in respect of the Joint Venture's assessment of interim Application 19. The Joint Venture made deductions totalling some £1.5m (excluding VAT) from the application which Ledwood submitted in July 2007 in the sum of just over £2.2m (excluding VAT). The balance was paid to Ledwood.

3. Ledwood commenced adjudication under clause 20.4 of the subcontract which they had entered into on or about 3rd March 2005. The subcontract would not have contained a mandatory provision for adjudication under section 108 of the 1996 Act, as the operations in this case are not construction operations within the meaning of section 105(2) of that Act. The subcontract, however, incorporates the following provision:- *'Notwithstanding any other provision of this agreement, either party may decide at any time to refer a dispute to adjudication under section 108 of the Housing Grants (Construction and Regeneration) Act 1996 in accordance with the adjudication provisions of the Scheme for Construction Contracts (SI 1998 No. 649) ("the Scheme") subject to the amendments set out in the remainder of this clause 20.4.'*

4. By a notice of referral dated 28th August 2007, Ledwood commenced the adjudication. The Adjudicator made his decision, dated 10th October 2007. He held that the Joint Venture had wrongly withheld £1,215,067.64 from its payment against Application 19 and expressed his decision in these terms at the conclusion:-

   "(7) The total sum which can properly be deducted from Application 19 (exclusive of VAT) is £325,390.36. Whessoe has wrongly withheld £1,215,067.64 (exclusive of VAT).

   (8) Interest at the rate of 1% above the Bank of England base rate shall run on the total of the wrongly deducted amount (£1,215,067.64) for the period from 3rd August 2007 to the date of actual payment."

5. There is no challenge to the decision or the jurisdiction of the Adjudicator. Both parties are agreed that the Adjudicator's decision should be enforced. Although initially the Joint Venture indicated that it would make payment of the outstanding sums by 19th October 2007, it did not make payment. Instead, the Joint Venture wrote to Ledwood on 19th October 2007 and issued revision 2 of a payment notice in respect of Application 22, in which it stated that the sum due to Ledwood was a negative sum of £224,099.43. It, therefore, made no further payment.

6. On 24th October 2007, Ledwood issued these Part 8 proceedings and directions were given which led to a hearing on 16th November 2007. At that hearing, Ledwood was represented by James Howells and the Joint Venture was represented by Adam Constable.

The Issues

7. The issues which arise in these Part 8 proceedings can be summarised as follows: (1) Is the risk/reward régime to be applied to all applications or only those after completion? The risk/reward régime, referred to as "pain and gain", limits Ledwood's entitlement to payment of costs by reference to target hours. (2) Should the Adjudicator's decision be given effect by applying his decision to Application 19 or Application 22? (3) If the risk/reward régime applies to applications for payment prior to completion, can the Joint Venture set off a sum in respect of an adjustment for risk/reward? I shall consider these issues in turn.

The risk/reward regime.

8. Clause 14 of the subcontract deals with the subcontract price and payment. Clause 14.1(a) states: *"Payment for the subcontract work shall be made on the basis of the subcontract price as determined in accordance with the subcontract based on the target cost, subject to adjustments."*

9. Applications for interim payments are dealt with under clause 14.2, which provides: *"The subcontractor shall submit a draft statement in two hard copies and one electronic copy to the contractor within five days after the end of each month in a form approved by the contractor, showing in detail the amounts to which the subcontractor considers himself to be entitled together with all necessary supporting documentation (in accordance with the details of payment particulars as required by Exhibit E) and a comparative analysis against the target cost. The draft statement shall include the following items as applicable in the sequence listed … (d) all necessary adjustments as Exhibit E."*

10. Exhibit E contains payment particulars and commences by stating: *"Full and concise details are presented in the agreed notes of commercial meetings Nos. 1 to 11 inclusive (signed by both parties) as contained in Exhibit F."*

11. Exhibit E contains the subcontract target cost of £11,717,373, which is subject to adjustment. It is based on target hours. The agreed total target hours are 241,358, but those hours are to be revised to reflect any departures from the perceived scope of the subcontract works. There is a provision in clause 13.2 of the subcontract for adjusting the target cost in relation to variations. Exhibit E also includes at paragraph 8 provisions as to risk/reward. It provides:

    "The risk/reward is limited to the costs relating to target labour hours and commensurate values only as set out in the schedule. For the purposes of clarity, the supervision, plant etc are not subject to the target cost and therefore do not form part of the risk/reward schedule."

12. There is then a table, which shows that for an underspend on target hours the Joint Venture benefits by 40% and Ledwood by 60%, without limitation on the amount of underspend. Where the overspend is up to 20% of the cost of the target hours, then the overspend is shared 50%/50%, but where it exceeds 20% of the cost of the target hours, Ledwood bears the full 100% of the overspend. In fact, the table was later varied by a settlement agreement made between the parties on 11th April 2007, so that the Joint Venture benefits in respect of 100% of underspend, Ledwood bears 100% of the overspend up to 7.5% of the final target man hours and above that the overspend is shared 50%/50%. What is not stated in Exhibit E is when the relevant calculation is to be carried out.

13. Ledwood refers to Exhibit F, which is a series of notes of 11 commercial meetings, which took place between 20th December 2004 and 11th February 2005, prior to the subcontract. In general terms, at these meetings the parties set out their positions and when these led to agreements they were then incorporated into Exhibit E.

14. In relation to risk/reward, at item 22 of meeting 1, it is noted that: "The JV confirmed their understanding of the risk/reward as follows." There is then a table which sets out what became paragraph 8 of Exhibit E. It then states: "(Calculated and paid on completion)" and continues: "Ledwood to provide their agreement".

15. At meeting 3, there was a discussion noted as follows: *"Ledwood set out the following for the JV review. Main board policy dictated the maximum overspend exceeding 20% of the subcontract target value be capped at £600,000 where Ledwood were 100% liable. Thereafter Ledwood require reimbursement without any addition of 10%. JV stated in consideration of this new departure they would reassess the savings relative to any capping. JV to review in the context of the original agreement."*

16. At meeting 4, it was stated that: "JV still to review Ledwood capping." At meeting 7, the matter was stated to be in abeyance and, at meeting 9, the JV was to action the item. At meeting 10, it was stated that: *"For the purpose of absolute clarity, it was agreed the risk/reward was limited to the labour hours and commensurate values. JV still to review."*

    It was also noted that all outstanding matters, with the exception of risk/reward, had been addressed.

17. At the final meeting, No. 11, risk/reward was then dealt with. The Joint Venture said that Ledwood's proposal of capping the risk element of the risk/reward was unacceptable. After a discussion, the conclusion was that the Joint Venture and Ledwood would review the notes and, as a post-meeting note, it stated:

    "Ledwood agreed to adhere to the original risk/reward principles, ie no capping."

    There was no discussion on the figures in the table or the words in parenthesis "calculated and paid on completion".

18. Exhibit E then included the table from meeting 1 and what had been stated for "absolute clarity" at meeting 7, although worded differently. There was no reference to "calculated and paid on completion". Is that nonetheless incorporated into the subcontract?

19. Mr Howells submits that clause 14 of the subcontract does not require a calculation of risk/reward at each payment application but only a comparative analysis against target costs and that the reference to adjustments in Exhibit E means that this is the place where such calculations are set out. He submits that the reference within Exhibit E to Exhibit F providing "full and concise details" is sufficient to introduce the provisions from Exhibit F that risk and reward is to be calculated and paid on completion. He also submits that the risk/reward provisions would otherwise be difficult to apply to each payment application, particularly in respect of underspend.

20. Mr Constable submits that clauses 14.1(a) and 14.2 point towards risk/reward being dealt with on applications for interim payments. He contends that the reference in parenthesis in Exhibit F to "calculated and paid on completion" is not sufficient to incorporate that provision, and there is nothing to show that this was agreed. He submits that Exhibit E instead reduces the various agreements contained in the notes of the meetings into one exhibit. He submits that the phrase "calculated and paid on completion" is not a matter which can be added to Exhibit E by relying on the reference in Exhibit E to "full and concise details" being included in Exhibit F.

21. I have come to the conclusion that Mr Constable's submissions are to be preferred. Clause 14.1(a) expressly states that payment is to be made on the basis of the subcontract price "as determined in accordance with the subcontract based on the target cost, subject to adjustments". In the absence of anything further, payment must therefore be based on the subcontract price and the target cost. In addition, applications for interim payment under clause 14.2 have to include a comparative analysis against target cost. This indicates that such an analysis is relevant to interim payments. Further, clause 14.2 states that all necessary adjustments in Exhibit E are to be taken into account in applications for interim payments and, in the absence of anything further, that would include the risk/reward provision in Exhibit E.

22. The question of when the risk/reward mechanism is to be applied is not dealt with in Exhibit E, although, for instance, the timing of the payment of retention is dealt with in paragraph 9 of Exhibit E. I do not consider that the opening words of Exhibit E can incorporate into Exhibit E matters which are other than "full and concise details" of the agreement set out in Exhibit E.

23. The practice of including agreed minutes of meetings as an exhibit to a contract generally gives rise to problems. In this case, I consider that the intention of Exhibit E was to record the agreements made in the meetings referred to in Exhibit F. An analysis of the notes of the meetings shows that where matters were stated to be *"agreed*" in those notes, they were transferred into Exhibit E. I consider that the reference to *"full and concise details*" being

given in Exhibit F is a reference to details of matters which were included in Exhibit E. Thus, if there is doubt as to the figures agreed in Exhibit E, then Exhibit F contains the details of how those agreed figures were derived.

24. I do not consider that a reference in a minute in Exhibit F can take a matter mentioned at one meeting, such as *"calculated and paid on completion*" and then, without it being shown to have been agreed in the notes, or to have been included in Exhibit E, to make it part of the matters agreed. There is no indication in the notes that the parties agreed that provision or turned their minds to the matter. Whilst Ledwood dropped their requirement for a cap or limit on the risk element, there is no mention of when risk/reward was to be applied. Many matters were discussed in the meetings, and I do not consider that such matters can be relied on as being agreed unless there is evidence of such agreement.

25. Therefore, I do not consider that the reference in parenthesis to *"calculated and paid on completion*" was incorporated as an agreed provision. As a result, I consider that the risk/reward mechanism is to be applied in relation to interim payments.

Application 19 or Application 22?

26. Ledwood made Application 19 in July 2007. Before the Adjudicator made his decision, there had been three further applications for interim payment, Applications 20, 21 and 22. Application 22 was made on 4th October 2007 and, on 11th October 2007, the Joint Venture issued a revised payment notice showing an amount of £267,332.73 (plus VAT) due to Ledwood. No adjustment was made at that stage in respect of risk and reward. When the Joint Venture received the Adjudicator's decision, they issued a further revision to the payment notice in relation to Application 22, in which they gave effect to the Adjudicator's findings on deductions, but assessed a deduction for risk and reward in the sum of £1,817,227. That revised payment notice, dated 19th October 2007, led, as I have said, to a negative sum due to Ledwood.

27. The Joint Venture contends that the Adjudicator did not decide that any payment was due and it was therefore entitled to treat his findings as applying to Application 22 and to revise the payment notice under clause 14.3 of the subcontract so that no net payment was due to Ledwood.

28. Although the Adjudicator did not say in express terms that the effect of his decision was that Ledwood should be entitled to payment, he was deciding whether the Joint Venture was entitled to make the deductions which they had made in respect of Application for payment 19. In determining that the Joint Venture had wrongly withheld £1,215,067.64 (excluding VAT) and that they should pay interest on that amount to "the date of actual payment", the Adjudicator was clearly intending, in my judgment, that the sum withheld should be paid.

29. In addition, under paragraph 21 of the Scheme for Construction Contracts incorporated by clause 20.4 of the subcontract, it is provided that: *"In the absence of any directions by the Adjudicator relating to the time for performance of his decision, the parties shall be required to comply with any decision of the Adjudicator immediately on delivery of the decision to the parties in accordance with this paragraph."*

30. I consider that the Adjudicator's decision meant that, as at the date for payment of Application 19 in August 2007, a further sum should have been paid but was not paid because of the wrongful deductions made by the Joint Venture. The essential purpose of adjudication of interim payments is to allow a party to obtain cashflow. In general, therefore, 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: see the summary of earlier decisions in the judgment of Mr Justice Jackson in ***Balfour Beatty Construction v Serco*** [2004] EWHC 3336 at paragraph 53, cited below.

31. To permit the Joint Venture to use an adjustment to the payment notice for Application 22 to give effect to the Adjudicator's decision would ignore the wrongful deduction from Application 19 and permit the Joint Venture to take account of subsequent events and other rights of set-off which it was not entitled to deduct and did not seek to deduct from the payment due on Application 19. In my judgment, the Adjudicator's decision should be given effect by applying that decision to Application 19 and not Application 22.

The ability to set off for risk and reward on Application 19.

32. The Joint Venture refers to the Adjudicator's finding that Ledwood was entitled to be paid at 28,486 hours and that Adjustment 14 made to Application 19 by the Joint Venture should not have been made. The Joint Venture, therefore, submits that the effect of the Adjudicator's decision is that a further 28,436 hours should be added. This then gives rise to a risk/reward adjustment which should now be made in respect of Application 19.

33. Mr Constable submits that the application of risk/reward in this case is based on the logical corollary of the Adjudicator's decision and is similar to a case where the consequence of the decision is that an employer is entitled to deduct liquidated damages. He referred me to the decision of Mr Justice Jackson in ***Balfour Beatty Construction v Serco***, where he considered the previous decisions and said this at paragraph 53:

"I derive two principles of law from the authorities, which are relevant for present purposes.

(a) Where it follows logically from an adjudicator's decision that the employer is entitled to recover a specific sum by way of liquidated and ascertained damages, then the employer may set off that sum against monies payable to the contractor pursuant to the adjudicator's decision, provided that the employer has given proper notice (insofar as required).

(b) Where the entitlement to liquidated and ascertained damages has not been determined either expressly or impliedly by the adjudicator's decision, then the question whether the employer is entitled to set off liquidated and

ascertained damages against sums awarded by the adjudicator will depend upon the terms of the contract and the circumstances of the case."

34. In this case, does it follow logically from the decision of the Adjudicator that the Joint Venture is entitled to recover a specific sum by way of adjustment of the risk/reward element?

35. Whist Ledwood has accepted that if risk/reward is to be deducted from Application 19, then summary judgment should be based on the figure of risk and reward of £797,139 on the basis of the Joint Venture's figures, that does not mean that there is an undisputed or indisputable application of risk/reward. The first question which has to be determined is whether such a set-off can be made.

36. It is clear from the evidence that there is a dispute between the parties as to the expended man hours and the revised target man hours. This can be seen from paragraph 40 and following of the witness statement of Mr McLean submitted on behalf of Ledwood. Indeed, he says at paragraph 58 that, even at the end of September 2007, Ledwood had not expended more than the properly revised target hours.

37. In my judgment, whilst the natural corollary of the Adjudicator's decision is that it increases the number of expended hours in the "pain/gain" calculation, the calculation of that effect is not undisputed or indisputable. This is not a case like a calculation of liquidated damages which can be made using the number of weeks decided by the Adjudicator and applying the agreed rate. The issue of deduction of liquidated damages arises in a case where the Adjudicator deals with the extensions of time but does not deal with the consequential effect on an undisputed or indisputable claim for liquidated damages. It is a particular exception which relates to the manner and extent of compliance with the Adjudicator's decision. It does not, in my judgment, give a wider power to set off sums generally against an Adjudicator's decision.

38. In this case, as can be seen from the disputed evidence, it is necessary to consider both the overall man hours expended and the revised target man hours before the agreed formula can be applied. The evidence shows that both the overall man hours expended and the revised target man hours are disputed. I therefore do not consider that the Joint Venture can set off a sum for the risk/reward adjustment against the Adjudicator's decision relating to Application 19.

Summary

39. In those circumstances, I have come to the conclusion that Ledwood is entitled to summary judgment, based on the Adjudicator's decision, for the sum of £1,215,067.64 plus applicable VAT, together with interest on which I will hear submissions.

40. I am grateful to both counsel for their excellent submissions and to the solicitors for providing the court with all the documents within the necessarily tight time limits.

Costs

41. So far as costs are concerned, it is submitted on behalf of Ledwood that it has been successful and, therefore, it should have its costs. On behalf of the Joint Venture, it is submitted that there was an important issue between the parties relating to the ability to apply the risk/reward régime prior to completion, which has been decided in favour of the Joint Venture.

42. In this case, I bear in mind that the underlying purpose of the proceedings was Ledwood's claim to obtain summary judgment, which it has succeeded in obtaining. Therefore, it is clear, in my view, that *prima facie* they are entitled to their costs. However, as in many cases there are issues which can be usefully determined as part of a Part 8 application. In this case, in particular, the issue of whether or not risk/reward can be applied on an interim basis has been considered and determined in favour of the Joint Venture and was evidently a matter which needed resolution. In those circumstances, I consider that in my discretion I should take into account the fact that a great deal of the argument related to the issue of risk/reward on which the Joint Venture have succeeded. In my judgment, the appropriate way of dealing with it is to allow the Claimant 70% of their costs and to summarily assess those on a standard basis.

43. I have been provided with a schedule which, excluding VAT (which should be excluded in this case), shows a figure of £26,974 as costs. It is said on behalf of the Joint Venture that there may be some duplication within the attendances figure and the work done on documents. When the court is carrying out a summary assessment, it should be aware that it is carrying an assessment on a summary basis and that if a detailed assessment were carried out, there would be a more detailed enquiry into the matter. I consider that when assessing on a summary basis there is a need to be cautious about certain hours expended. The reasonableness of that is for Ledwood to demonstrate.

44. In my judgment, the appropriate figure in this case is a base figure of £25,500, and the sum which I summarily assess, therefore, is 70% of £25,500.

Mr James Howells for the Claimant.
Mr Adam Constable for the Defendants.