

WAVERLEY BOROUGH COUNCIL

EXECUTIVE

27 MARCH 2019

Title:

CONTRACTUAL DISPUTE RESOLUTION AND REQUEST FOR BUDGET VIREMENT

**[Portfolio Holders: Cllr Jenny Else and Cllr Ged Hall]
[Wards Affected: All]**

Note pursuant to Section 100B(5) of the Local Government Act 1972

An Annexe to this report contains exempt information by virtue of which the public is likely to be excluded during the item to which the report relates, as specified in Paragraph 5 of Part I of Schedule 12A to the Local Government Act 1972, namely:

5. Information in respect of which a claim to legal professional privilege could be maintained in legal proceedings.
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Summary and purpose:

This report outlines the contractual dispute that has arisen relating to the construction of the Memorial Hall, Babbs Mead, West Street, Farnham following practical completion of the building which was achieved on 29 August 2018.

The Council had been in the process of questioning the Extensions of Time awarded on this contract by Lytle Associates, the appointed Contract Administrator. At the end of January 2019, Armfield Construction Ltd submitted an inflated interim account, application no. 26, for work on the Hall.

On 19 February 2019, an Adjudication Referral Notice was received by the Council from Armfield Construction Ltd (ACL) regarding alleged non-payment of their payment application.

This report advises the Executive on the options that result from the Adjudication process and recommends a course of action to resolve this matter, with a virement decision as a financial solution.

Equality and Diversity Implications:

There are no such implications associated with this report.

Financial Implications:

The total budget approved by Council for the Memorial Hall project is £3.2m. The substantial part of this budget is the estimated main contractor cost. This report proposes a virement of £375,000 to cover the above-budget contractor cost arising from a negotiated final account settlement.

The adjudication Referral Notice issued by the main contractor, ACL, on 19 February 2019 has alleged non-payment of £854,887.84 as per ACL's payment application (No 26). If the Adjudicator makes a decision in ACL's favour the full amount would likely be payable within 7 days of the adjudicator's decision. If this were the case, the Council could issue a secondary adjudication against ACL.

The recommendation of this report is to agree to a negotiated final account outside of the adjudication process which significantly reduces the Council's cost to £375,000. Of this amount, approximately £170,000 was to be expected as it relates to modifications and improvements made to the project by the Council (see para 2.3); the balance of £205,000 is the negotiated full and final settlement, which removes the possibility of further dispute and claims from ACL. The amount can be met under the Council's agreed virement scheme and authorised by the Executive.

It is proposed to vire £375,000 from Frensham Hub capital budget which has approved funding for the entire estimated project cost. The Council has recently applied for over £500,000 of grant towards this project so it is appropriate at this stage to transfer capital funding to meet the urgent need. The Council remains committed to the Frensham scheme and hopes that the funding bid will be successful. In the event that it is not, the financing of the scheme will need to be reviewed.

Legal Implications:

The Council entered a JCT "Standard Build Contract with Quantities 2011" with Armfield Construction Limited on 12 October 2016. External specialist solicitors assisted with the drafting and completion of the JCT contract

In 2016, the Council appointed Michael Edwards Consultants (MEA) to act as Quantity Surveyors on the project and Lytle Associates as a) Architect and b) Contract Administrator to administer the contract. Since the project commenced, the Council has sought external specialist construction advice from Browne Jacobson solicitors under the Surrey framework agreement.

ACL is entitled by the Housing Grants, Construction and Regeneration Act 1996 ("Construction Act 1996") and the contract, to refer a dispute under a construction contract to adjudication at any time. This is a tactic which many contractors use to assist their cash flow.

1. Background

- 1.1 On 12 October 2016, the Council, following an appropriate procurement process, entered into a JCT Standard Building Contract with Armfield Construction Limited (ACL). The work was administered, from a project view point by an external Contract Administrator, Lytle Associates. A Quantity Surveyors service was bought in from Michael Edwards Consultants Limited (MEA).
- 1.2 The contract was for part demolition, extension, remodelling and refurbishment works to create a new multi-purpose facility, with external works at the Memorial Hall, Babbs Mead, West Street, Farnham.
- 1.3 The works were commenced on 5 September 2016. There were significant delays throughout the project and the works were certified for Practical Completion on 29

August 2018, nearly a year late. There is disagreement between the Council and ACL as to where the responsibility for that delay lies.

- 1.4 Works to complete the building and snagging have continued following Practical Completion. These works included some finishing of the external surfaces and releveling of the parking areas, internal finishing and painting.

2. Extension of Time

- 2.1 Construction contracts generally allow the construction period to be extended where there is a delay that is not the contractor's fault. This is described as an Extension of Time ("EoT").

- 2.2 Some EoT was agreed on this contract early on which extended the finish date from late August until 27 October 2017. This allowed for the additional changes to the design and the subsequent impact upon the supply and installation of the steel frame.

- 2.3 The agreed EoTs extended the build time by 10 weeks until October 2017. These additional EoTs primarily covered changes to the building made to accommodate Waverley Training Service. Further changes and improvements were made by Waverley as detailed in Appendix 1, which have costs and some time associated with them. These changes were made to:

- 1) ensure the maximum usability of the building
- 2) make it more readily accessible to all in the community
- 3) protect the privacy of the surrounding properties and neighbourhood.

- 2.4 Had the project progressed in the normal way officers would have been likely to request an additional budget to cover some of these items at completion when full costs were known. Officers now know that these changes cost an additional £170,000. The position on the Adjudication makes challenging them unlikely.

- 2.5 The Council promptly took external legal advice and began the initial process of challenging this decision through a series of letters to the Contract Administrator, Lytle. During this early stage of questioning the EoT's ACL began the formal Adjudication process

3. Payment Dates

- 3.1 The standard JCT Contract contains a process for payment of contracted works. In this JCT contract the due date for payments is the 5th of the month or the nearest working day. This is a key part of the technical dispute which is critical to ACL's case. The process is as follows:

- a) The payment process is triggered by the contractor, ACL, putting in an interim payment application, No 26 in this instance.
- b) The Quantity Survey assesses that application and submits a valuation of the works that have been done in that period; (this could be zero).

- c) The Contact Administrator then issues an Interim Certificate to the Council stating the sum that they consider due. The obligation to issue Interim Certificates is a mandatory one under the contract.
- d) The failure to issue an Interim Certificate has the effect of turning the Contractor's Interim Payment Application into an Interim Payment Notice.
- e) This in essence means that the sum on the Contractor's Interim Payment Application is then due.

4. Adjudication

- 4.1 Generally, adjudicators do not have the power to award costs (other than their own fees and expenses). Adjudication must adhere to strict timescales and typically the process takes up to 28 days.
- 4.2 The adjudicator's decision is taken purely on the JCT contractual terms with no regard to "reasonableness" from either party in conduct. Importantly, the parties do not have the ability to vary the terms of the Adjudication decision.

5. Options available to the Council

5.1 Option 1: Allow the Adjudication to continue

The Council does not have the ability to counter the Adjudication until it has been determined. We have the option to do nothing and allow ACL to take us through the process.

If the Adjudicator makes a decision in ACL's favour in relation to payment application No. 26, they will award the full £854,887.84 payable by the Council within 7 to 14 days, plus costs. The Adjudicator does not have the ability to lessen the amount or vary its terms.

If this happened, once we have paid the full amount a secondary adjudication could then be issued by the Council against ACL for the true valuation of the application No. 26.

It should be noted that application 26, which the Adjudication relates to, is not a full and final valuation and further invoices are likely to be received during a further protracted process.

- 5.2 The Adjudicator could make a decision in Waverley's favour in relation to ACL's payment application No. 26, denying the full £854, 887.84 is payable by us. If this course of action took place, we would then be left to settle the final account through a series of ongoing payment applications. Waverley's external lawyers have indicated what they consider to be Waverley's prospects of success in the adjudication and this information is included at exempt annexe.

5.3 Option 2: Negotiate a "without prejudice" settlement with ACL

A potential "Without Prejudice" settlement has been negotiated by Council Officers with ACL to agree a full and final settlement of the account. Any such settlement outside of the adjudication process could avoid lengthy and expensive legal action

to recover the true amount from ACL and any other third parties, which carries considerable risk.

If this course is taken the Council would need additional budget provision of £375,000 to meet the costs of the settlement. This is made up of known costs as outlined in 2.3, plus the a negotiated settlement. Whilst officers dispute the basis of this claim, failing to take this course of action could expose Waverley to approximately at least a further £500,000 of costs through the formal adjudication process.

Summary of Options

	Pros	Cons
Option 1	<p>Do nothing and let the ACL Adjudication run</p> <p>It is possible that the Adjudicator would find in favour of WBC (see exempt Annexe).</p> <p>If the Adjudicator finds against the Council, a second adjudication could be launched with some chance of recovering some of the £854,887.84.</p>	<p>Time involved in formal adjudication process.</p> <p>Additional costs could be awarded against us, including all Adjudication costs.</p> <p>No guarantee that Waverley can recover any additional.</p> <p>Further invoices could be submitted by ACL as current dispute is on interim payment.</p>
Option 2	<p>Agree a negotiated settlement</p> <p>Certainty of outcome, known costs and agreed final outcome of the payment</p> <p>No further protracted or costly dispute.</p>	<p>We will be unable to challenge ACL any further on these disputed costs.</p>

- 5.4 Since ACL launched the Adjudication process, members of the Executive and the Chairmen and Vice-Chairmen of the Value for Money Overview and Scrutiny Committee and the Audit Committee have been kept apprised of progress with the negotiations. In support of the options appraisal the template adopted by the Council, following the Audit Committee's consideration, has been used and this is attached at Annexe 2.

6. Conclusion

- 6.1 ACL has issued an Adjudication against the Council in relation to Interim Payment Application No. 26. The Council considers that part of ACLs application is inflated and without sufficient evidence provided to the Quantity Surveyor
- 6.2 This type of claim through a contractual technicality is named as a 'smash and grab' claim, although lawful it is a disappointing approach to take to a contractual dispute.

The Council is exposed to considerable potential costs through this Adjudication action. However, officers are pleased that ACL have subsequently been prepared to negotiate a final account settlement outside of the Adjudication process.

- 6.3 On balance, and having taken the pros and cons of all available options into account, it is recommended that option 2 – the agreement of a negotiated settlement – offers the best possible and most proportionate course of action in this situation.

Recommendation

That the Executive:

1. Authorises officers to finalise and settle the negotiated settlement with Armfield Construction Ltd on the broad terms set out in this report, with the agreement of the detailed legal documents delegated to the Section 151 Officer and Portfolio Holder for Finance in consultation with the Borough Solicitor; and
2. in accordance with Waverley's approved scheme of virement, agrees to vire £375,000 of capital budget from the Frensham project to the Memorial Hall capital scheme budget to meet the unbudgeted contractor cost resulting from this settlement.

Background Papers

There are no background papers (as defined by Section 100D(5) of the Local Government Act 1972) relating to this report.

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Annexe 1

Main elements of improvements and additional costs

Improved lighting, heating & sound system for Main Hall	£34,000
Improved Kitchen Extract	£12,000
Replacement windows throughout building and window automation	£37,600
Increased power and data requirements	£25,000
Additional Asbestos Removal	£18,500
Additional ground levelling for ease of access & additional drainage	£23,000
Additional Holding Bolts	£6,000