

Binning the Black Bag (What Material Can an Adjudicator Consider?)

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Introduction

This article considers what material an adjudicator, appointed under rules complying with s.108 of the Housing Grants Construction and Regeneration Act 1996 (HGCRA), can consider in reaching his determination: in particular, whether an adjudicator can only consider facts and arguments that have been aired between the parties prior to the commencement of the adjudication. It concludes by considering whether adjudicators can consider defences that do not arise under the contract on which they are appointed.

The restricted interpretation of the word "dispute" and the rise of the black bag theory

In *Edmond Nuttall v RG Carter*¹ H.H. Judge Seymour Q.C. said, at [36]:

“. . . what constitutes a 'dispute' between the parties is not only a 'claim' which has been rejected, if that is what the dispute is about, but the whole package of arguments advanced and facts relied upon by each side. No doubt, for the purposes of a reference to adjudication under the 1996 Act or equivalent contractual provision, a party can refine its arguments and abandon points not thought to be meritorious without altering fundamentally the nature of the 'dispute' between them. However, what a party cannot do, in my judgment, is abandon wholesale facts previously relied upon or arguments previously advanced and contend that because the 'claim' remains the same as that made previously, the 'dispute' is the same.”

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¹ [2002] B.L.R. 312.

This restricted interpretation of the word “dispute” led to what subsequently became known as the black bag theory of adjudication. Parties who disagree about claim must fully air the arguments and facts that divide them before it can be said that a dispute has crystallised. Only then can a claim be referred to adjudication, bundling up all those arguments and facts into a black bag and passing it to the adjudicator. The adjudicator reaches his decision based on what he finds in the black bag. Neither the adjudicator, nor either party, can put anything more into that bag.

The black bag theory gained a certain vogue because it appeared to address policy consideration concerning the risk, adjudication being a 28-day dispute resolution process, of ambush and possible unfairness of new material being introduced during the course of an adjudication. These policy considerations were, indeed, the reason why Judge Seymour Q.C. interpreted the word “dispute” as he did. Again from [36]:

“The whole concept underlying adjudication is that the parties to an adjudication should first themselves have attempted to resolve their differences by open exchange of views and, if they are unable to, they should submit to an independent third party for decision the facts and arguments which they have previously rehearsed among themselves. If adjudication does not work in that way there is the risk of premature and unnecessary adjudications in cases in which, if only one party had a proper opportunity to consider the arguments of the other, accommodation might have been possible. There is also the risk that a party to an adjudication might be ambushed by new arguments and assessments which have not featured in the ‘dispute’ up to that point but which might have persuaded the party facing them, if only he had an opportunity to consider them . . .”

The demise of the restricted view of the word “dispute”

The difficulty with the approach, as was soon recognised, is that it allows endless scope for the intended respondent to an adjudication to delay and prevaricate, by seemingly endless, and often costly, requests for clarification, discussion and negotiation, and once adjudication is commenced, to dispute the adjudicator’s jurisdiction on the grounds that there is more to discuss and the dispute has not crystallised. Moreover, since the meaning of the word “dispute” has been the subject of detailed consideration in the law of arbitration, there was the further problem of whether, the relevant wording in the Arbitration Act 1996 and in Pt II of the HGCRA being identical,² policy considerations, such as those identified by Judge Seymour Q.C., were sufficient to justify different meanings being given to the word “dispute” in these two methods of dispute resolution.

The weight of subsequent authority³ moved strongly against the restricted interpretation of the word “dispute” and it has now been laid to rest by the

² In both cases, “‘dispute’ includes any difference”. See HGCRA 1996 s.108(1) and AA 1996 ss.6(1) and 82(1).

³ See, for example, *Cowlin Construction v CFW Architects* [2003] B.L.R. 241, *London and Amsterdam v Waterman Partnership* [2003] EWHC 3059, *AWG Construction Services v Rockingham Mortor Speedway Ltd* [2004] EWHC 888, *William Very (Glazing Systems) Ltd v Furling Homes Ltd* [2005] EWHC 138.

Court of Appeal in *AMEC Civil Engineering Ltd v The Secretary of State for Transport*.⁴

At first instance in that case,⁵ Jackson J. after a review of the relevant case law concluded at [68]:

- “1. The word ‘dispute’ which occurs in many arbitration clauses and also in section 108 of the Housing Grants Act should be given its normal meaning. It does not have some special or unusual meaning conferred upon it by lawyers.
2. Despite the simple meaning of the word ‘dispute’, there has been much litigation over the years as to whether or not disputes existed in particular situations. This litigation has not generated any hard-edged legal rules as to what is or is not a dispute. However, the accumulating judicial decisions have produced helpful guidance.
3. The mere fact that one party (whom I shall call ‘the claimant’) notifies the other party (whom I shall call ‘the respondent’) of a claim does not automatically and immediately give rise to a dispute. It is clear, both as a matter of language and from judicial decisions, that a dispute does not arise unless and until it emerges that the claim is not admitted.
4. The circumstances from which it may emerge that a claim is not admitted are Protean. For example, there may be an express rejection of the claim. There may be discussions between the parties from which objectively it is to be inferred that the claim is not admitted. The respondent may prevaricate, thus giving rise to the inference that he does not admit the claim. The respondent may simply remain silent for a period of time, thus giving rise to the same inference.
5. The period of time for which a respondent may remain silent before a dispute is to be inferred depends heavily upon the facts of the case and the contractual structure. Where the gist of the claim is well known and it is obviously controversial, a very short period of silence may suffice to give rise to this inference. Where the claim is notified to some agent of the respondent who has a legal duty to consider the claim independently and then give a considered response, a longer period of time may be required before it can be inferred that mere silence gives rise to a dispute.
6. If the claimant imposes upon the respondent a deadline for responding to the claim, that deadline does not have the automatic effect of curtailing what would otherwise be a reasonable time for responding. On the other hand, a stated deadline and the reasons for its imposition may be relevant factors when the court comes to consider what is a reasonable time for responding.
7. If the claim as presented by the claimant is so nebulous and ill-defined that the respondent cannot sensibly respond to it, neither silence by the respondent nor even an express non-admission is likely to give rise to a dispute for the purposes of arbitration or adjudication.”

⁴ [2004] EWCA Civ 1757; [2005] B.L.R. 63.

⁵ [2004] EWHC 2339, [68].

These seven propositions were broadly endorsed by the Court of Appeal in *Collins (Contractors) Ltd v Baltic Quay Management (1994) Ltd*⁶ and, subsequently, on appeal in *AMEC v Secretary of State for Transport*, itself. In the latter case May L.J., with whom Hooper L.J. agreed, stated:

“30. In *Collins (Contractors) Ltd v. Baltic Quay Management (1994) Limited* (2005) BLR 63, Clarke LJ at paragraph 68 quoted Jackson J’s seven propositions and said of them:

‘63. For my part I would accept those propositions as broadly correct. I entirely accept that all depends on the circumstances of the particular case. I would, in particular, endorse the general approach that while the mere making of a claim does not amount to a dispute, a dispute will be held to exist once it can reasonably be inferred that a claim is not admitted. I note that Jackson J does not endorse the suggestion in some of the cases, either that a dispute may not arise until negotiation or discussion have been concluded, or that a dispute should not be lightly inferred. In my opinion he was right not to do so.

64. It appears to me that negotiation and discussion are likely to be more consistent with the existence of a dispute, albeit an as yet unresolved dispute, than with an absence of a dispute. It also appears to me that the court is likely to be willing readily to infer that a claim is not admitted and that a dispute exists so that it can be referred to arbitration or adjudication. I make these observations in the hope that they may be of some assistance and not because I detect any disagreement between them and the propositions advanced by Jackson J.’

31. Each of the parties has accepted in this court that the judge’s propositions correctly state the law. I am broadly content to do so . . .”

Although Rix L.J. introduced a note of caution,⁷ this was more to do with what he saw as the need for a watering down of the proposition, in arbitration law, that a non-admitted claim was in dispute, because in adjudication “there is the different concern that parties may be plunged into an expensive contest, the timing provisions of which are tightly drawn, before they, and particularly the respondent, are ready for it. In this context there has been an understandable concern that the respondent should have a reasonable time in which to respond to any claim”.

In summary, the current position is now that a dispute can be crystallised by the making of a claim which is denied, or is met with prevarication or silence such as to evidence an intention not to admit it. It is not necessary for there

⁶ [2004] EWCA Civ 1757; [2005] B.L.R. 63.

⁷ *AMEC v Secretary of State for Transport* [2004] EWCA Civ 1757; [2005] B.L.R. 63, [62]–[68].

to be negotiation before a dispute can crystallise; indeed negotiation is, itself, evidence that a claim is not admitted.

Binning the black bag

But where does this leave the black bag theory? If there is no need to air fully all the arguments and facts that divide the parties before a dispute can crystallise, the black bag handed to the adjudicator at the beginning of the adjudication will be empty or contain little of assistance in understanding and determining the referred dispute. If new facts and arguments cannot be adduced during the course of an adjudication, the adjudicator might as well climb into the bag himself, for he will be working more or less in the dark and his determination little more than an expensive guess.

Not surprisingly the courts have never endorsed the black bag theory and, in a number of cases, have expressly recognised that parties are not precluded from introducing new facts and arguments during the course of an adjudication and that adjudicators do not go outside their jurisdiction by admitting and considering such material. Indeed, a point often overlooked by those favouring the black bag theory is that, since the adjudicator is given power to ascertain the facts and the law,⁸ and most rules flesh this out with express powers to question and require further information of the parties, it must be envisaged that this power will be exercised, thus new facts and arguments emerge during the course of an adjudication.

One of the earliest statements to this effect is by H.H. Judge Thornton Q.C. in *Fastrack Contractors Ltd v Morrison Construction Ltd*⁹:

“The Scheme gives the Adjudicator two powers: to take initiative in ascertaining the facts in the law . . . and to resign if the dispute varies significantly from the dispute referred to him . . . These powers show that it is possible that a dispute that has been validly referred to Adjudication can in some circumstances, as the details unfold during the Adjudication, become enlarged and change its nature and extent. If this happens it is conceivable that at least some of the matters and issues referred to adjudication by the referring party which were not previously encompassed within a pre-existing dispute could legitimately become incorporated within the dispute that is being referred during the process of its enlargement while the adjudication proceeds.”

In a number of cases adjudicators have been said to have erred in law and/or acted unfairly by failing to recognise this or by excluding material provided by one party simply because it had not been seen by the other party before the start of the adjudication.¹⁰ Thus, in *Buxton Building Contractors Ltd v Governors of*

⁸ This power must be included in adjudication rules if they are to comply with HGCRA 1996 s.108.

⁹ [2000] B.L.R. 168, [24]. This passage was cited with approval in *William Verry (Glazing Systems) Ltd v Furling Homes Ltd* [2005] EWHC 138.

¹⁰ While it may be that such errors do not or, given the Court of Appeal's current desire, as expressed in *Carillion Construction Ltd v Devonport Royal Dockyard* [2005] EWCA Civ 1358; [2006] B.L.R. 15 (CA), to restrict the grounds for challenging adjudicator's decisions, would no longer provide grounds for challenging the resulting decisions, they are still errors.

Durand Primary School,¹¹ Judge Thornton Q.C. held that it was incumbent on an adjudicator, in the circumstances of that case, to ascertain the applicable facts and law; thus identify the issues that had to be addressed in order to determine the dispute. By failing to do so and excluding material adduced by the responding party, the adjudicator had erred in law and acted unfairly.

Neither is a respondent party precluded from raising, in defence of a claim, new facts and arguments during the course of an adjudication merely because those facts and arguments were not advanced before the adjudication is commenced. In *KNS Industrial Services (Birmingham) Ltd v Sindall Ltd*,¹² H.H. Judge Humphrey Lloyd Q.C. observed:

“21. . . . As Judge Thornton said in *Fastrack*, the ‘dispute’ is whatever claims, heads of claims, issues or contentions or causes of action that are then in dispute which the referring party has chosen to crystallise into an adjudication reference. A party to a dispute who identifies the dispute in simple or general terms has to accept that any ground that exists which might justify the action complained of is comprehended within the dispute for which adjudication is sought. It takes the risk that its bluff may be called in an unexpected manner. . . .

25. . . . the dispute referred to the adjudicator included any ground open to Sindall which would justify not paying KNS.”

These principles were cited with approval by H.H. Judge Coulson Q.C. in *William Verry (Glazing Systems Ltd v Furlong Homes Ltd)*,¹³ where the contention was that the adjudicator had exceeded his jurisdiction by considering claims for an extension of time going beyond that contended for by the referring party, Furlong, that were first advanced by Verry, the responding party, during the course of an adjudication. The Judge continued:

“49. . . . Having made a general and unqualified request to the Adjudicator to decide the question of extension of time, Furling cannot now complain because, in seeking to defend themselves Verry have raised a variety of matters which (on Furlong’s approach) are new. Furling sought a resolution of that entitlement to an extension of time and they claimed positively that such an extension of time could not extend beyond the 2nd February 2004. Verry were entitled to defend themselves against that assertion and if that led them to rely on matters which were not part of a previous formal claim than there was nothing to stop Verry from doing so.

50. Accordingly I conclude that even if Section D did somehow constitute a new claim it was material which the adjudicator was entitled to take into account when deciding the wide ranging

¹¹ [2004] EWHC 733. Although the decision in this case, that these errors invalidated the adjudicator’s decision has been doubted by the Court of Appeal in *Carillion Construction Ltd v Devonport Royal Dockyard*, this does not call into question the judge’s conclusion that he adjudicator erred in law and acted unfairly.

¹² [2000] 75 B.L.R. 71.

¹³ [2005] EWHC 138.

dispute referred to him by Furlong. The jurisdiction challenge fails.”

It is sometimes suggested that this reasoning is limited to cases where the dispute encompassed by the notice of adjudication is expressed in general terms, sometimes referred to as a “kitchen sink adjudication”. If the notice of adjudication is drawn narrowly, a responding party can be precluded from adducing new facts and arguments during an adjudication.

While it is, of course, the case that the adjudicator’s jurisdiction is limited to determining the dispute characterised by the notice of adjudication, a party seldom commences adjudication without wanting relief of some sort from the other party, usually time or money. Thus, the dispute, as defined, will invariably concern the alleged entitlement to that relief, and encompass any available defences to that entitlement (that cause of action), whether advised prior to the commencement of the adjudication or not. As Jackson J. observed in *Quietfield Ltd v Vascroft Contractors Ltd*,¹⁴ when summarising, with approval, the above passages from *William Verry v Furlong Homes*:

“Where a claim is made in adjudication proceedings, the responding party can deploy all available defences. The responding party is not restricted to defences of which it has previously given notice and which have thereby generated the ‘dispute’ referable to adjudication. The responding party is not restricted to defences of which it has previously given notice and which have thereby generated the dispute referable to adjudication.”

In a subsequent case, *Kier Regional Ltd v City & General (Holborn) Ltd*,¹⁵ Jackson J. again had to consider whether an adjudicator had erred in law by deciding not to take account of new evidence, in the form of two expert reports, adduced by the responding party, City & General, because they were not known to the parties at the time the dispute crystallised. He did not have to decide the point since he concluded that such an error would not provide grounds for resisting enforcement of the adjudicator’s decision. Nevertheless, he considered that there was “considerable force in the contention that the Adjudicator ought to have taken the two expert reports into account”.

Furthermore, a dispute that is defined too narrowly may not be capable of generating a useful answer, in the sense of providing a basis for a time or money remedy or, if it does, may simply encourage the responding party to commence a cross-adjudication so that the full dispute is determined, not just the selected part of it encapsulated in the referring party’s of adjudication.

There is, in short, no current judicial support for the black bag theory and it should be binned. The true position is, it is submitted, that facts (including opinions) and arguments not aired between the parties prior to the commencement of an adjudication can be adduced during the course of an adjudication without undermining the adjudicator’s jurisdiction. Subject, of course, in the case of the referring party, to the new material not being relied on

¹⁴ [2006] EWHC 174, [41].

¹⁵ [2006] EWHC 848, [18] and [42]. City & General’s submissions on this point relied on the extensive powers given to the adjudicator to investigate the facts and law under cl.41A.5 of the Joint Contracts Tribunal (JCT) adjudication rules, under which the adjudicator was acting.

to found new claims for relief not encompassed by the dispute identified in the notice of adjudication or, in the case of the responding party, being relied on to found a case that is not a defence to the claims encompassed by that notice.

If new material is adduced there must be an opportunity for the party to whom such material is provided to consider and respond to it. But that is a management problem, which competent adjudicators can generally deal with. It is not a jurisdictional issue.

Defences that do not arise under the contract

In *Capital Structures Plc v Time & Tide Construction Ltd*,¹⁶ the parties concluded a settlement agreement expressly providing that, in the event of a default on its terms “the parties are free to take any dispute to adjudication using the scheme rules under the Housing Grants Construction and Regeneration Act 1996”. Time & Tide failed to pay part of the sum due from it under settlement in part, and Capital commenced adjudication seeking payment of that sum. Time and Tide resisted payment on the grounds that the settlement was voidable for economic duress and it had avoided the settlement on that ground; thus depriving the adjudicator, whose appointment was pursuant to a term of the settlement, of jurisdiction.

Those familiar with arbitration will appreciate that such a contention raises issues which, in arbitral law, are resolved by application of the doctrine of separability. This doctrine provides that an arbitration clause in a contract is a separate agreement from the contract in which it is found and may continue to exist to govern the determination of disputes, although the contract in which it is embodied does not.

H.H. Judge Wilcox Q.C. considered a certain amount of case law and commentary concerning this doctrine as it applies in arbitral law. He concluded, principally, on the basis of an *obiter* remark by Lord MacMillan in *Hayman v Darwins*¹⁷ that:

“If there has never been a contract at all there has never been as part of it an agreement to arbitrate. The greater includes the less. Further, a claim to set aside a contract on such grounds as fraud, duress or essential error, cannot be the subject matter of a reference under an arbitration clause in the contract sought to be set aside.”

The Judge also relied on a passage in Mustill & Boyd¹⁸ that:

“It must now be accepted as a possibility that circumstances which render the main contract voidable may also affect the agreement to arbitrate, and that in such cases the arbitrator may be deprived of the jurisdiction which he had at the outset if proper steps are taken to avoid the agreement form which his jurisdiction derives. . . .”

Having reached this conclusion as to the position in the law of arbitration, the Judge, not surprisingly, concluded that this applied equally to an adjudication

¹⁶ [2006] EWHC 591; [2006] B.L.R. 226.

¹⁷ [1942] A.C. 356, 371.

¹⁸ Companion to the second edition of Mustill & Boyd, *Commercial Arbitration* (2001), p.137.

provision. Thus, he held that if it was established that the settlement agreement had been avoided for duress, the adjudicator would have no jurisdiction, and, dismissing the application for summary judgment, gave leave to defend.

Unfortunately, the premise for this conclusion appears to have been reached per incuriam, as it takes too narrow a view of the doctrine of separability. This doctrine was recognised by the House of Lords in *Bremer Vulcan v South India Shipping Corp*¹⁹ It was subject to detailed consideration by the Court of Appeal in *Harbour Assurance Co (UK) Ltd v Kansa General Insurance Co Ltd*,²⁰ where it was held that an arbitration clause is not invalidated by an allegation that the contract in which it is contained is void for illegality. Since the greater must include the less, it is implicit in this conclusion that an arbitration clause is not invalidated simply by an allegation that the contract in which it is found is voidable. Indeed, the Court of Appeal in *Ashville Investments v Elmer Contractors*²¹ had previously held that an arbitrator could, under a widely worded arbitration clause, consider claims in misrepresentation.²²

As for the passage Mustill & Boyd relied on by the Judge, this appears to have been taken out of context. Read in context,²³ the sense of the passage cited by the Judge is somewhat different:

“From this doctrine of separability . . . it was reasoned that not every circumstance which would impeach the initial existence of the underlying contract would necessarily impeach the validity of the arbitration agreement. . . .

In each case the question must be, whether the ground of nullity or invalidity impeaches the separable agreement to arbitrate. If it does not, the arbitrator has jurisdiction to entertain the question whether the grounds of nullity or invalidity impeaches the initial existence or validity of the main contract.

As a matter of logic, this approach should also apply to all questions of existence or initial validity of the arbitration agreement and to related questions . . . Logic would also seem to require that questions of the continuing existence of the contract (eg avoidance for misrepresentation and non-disclosure, duress or undue influence, repudiatory breach frustration, discharge by acceptance of repudiatory breach, etc) should also be governed by the doctrine of separability rather than by an arbitrary rule dividing questions of initial invalidity from all other vitiating factors. . . . Avoidance of the arbitration agreement for misrepresentation and on other

¹⁹ [1981] A.C. 909, see in particular the speech of Lord Diplock.

²⁰ [1993] Q.B. 701 (CA).

²¹ [1989] 1 Q.B. 488 (CA).

²² Subsequent to the preparation of this article, the Court of Appeal, in *Fiona Trust & Holding Corp v. Yuri Primalov* [2007] EWCA (Civ) 20 has, applying these principles, held that an arbitral tribunal's authority is not impeached by an allegation that contract in which the arbitration agreement is found, was procured by bribery; Longman LJ noting at paragraph 23, that section 7 of the Arbitration Act 1996 “codifies the principle that an allegation of invalidity of a contract does not prevent the invalidity question being determined by an arbitration tribunal pursuant to the (separate) arbitration agreement. It is only if the arbitration agreement is itself directly impeached for some specific reason that the tribunal will be prevented from deciding the disputes that relate to the main contract.”

²³ Companion to the second edition of Mustill & Boyd, *Commercial Arbitration* (2001), para.108-114. At the start of this paragraph both *Bremer Vulcan v South India* and *Harbour Assurance and Kansa* are referred to.

equitable grounds have received less attention in the cases. Until recently the accepted view was that an arbitrator always had jurisdiction to rule on issues such as this, when the continuing validity of the agreement was in question (sic, 'not in question'? assuming 'agreement' means the arbitration agreement?). However, it must now be accepted as a possibility that circumstances which render the main contract voidable may also affect the agreement to arbitrate, and that in such cases the arbitrator may be deprived of the jurisdiction which he had at the outset if proper steps are taken to avoid the agreement from which his jurisdiction derives. In the case of misrepresentation, for example, it will be necessary to examine questions of materiality, inducement, etc. separately in relation to the main agreement and the arbitration agreement. Even so, the court may be reluctant to conclude that what was a material inducement rendering the main contract voidable was also a material inducement in the making of the arbitration agreement. . . ."

It is clear, read in context, that "the agreement from which his jurisdiction derives" is the arbitration agreement, not the underlying contract or main contract. Mustill and Boyd are not, as the Judge appears to have thought, suggesting that an allegation, for example, of duress in the making of the main contract, necessarily impeaches the arbitration agreement contained in that contract. It does not. The arbitration agreement would only be impeached if, for example, during negotiations for contract a party was induced by duress into agreeing to arbitrate, as opposed to litigating disputes arising under that contract.

This common law doctrine is, in any case, now codified in s.7 of the Arbitration Act 1996, as follows:

"Unless otherwise agreed by the parties, an arbitration agreement which forms or was intended to form part of another agreement (whether or not in writing) shall not be regarded as invalid, non-existent or ineffective because that other agreement is invalid, or did not come into existence or has become ineffective, and it shall for that purpose be treated as a distinct agreement."

If, as the Judge accepted, principles derived from the doctrine of separability apply equally to adjudication provisions, it follows that an adjudication provision is not invalidated merely because the contract in which it is contained, is alleged or found to be void or voidable.

But, even so, there is a second question to consider: Does an adjudicator appointed under adjudication agreement which, because of the doctrine of separability, survives an allegation that the contract in which it is contained is avoided, have jurisdiction to consider, as a defence to the referring party's claim, that the contract on which the claim is based has been avoided for duress?²⁴

On one view of the law, the answer depends solely on the wording of the adjudication clause. If the wording is wide, encompassing "disputes under or in connection with the contract", the adjudicator will have jurisdiction to consider such a defence. If the wording is narrow, as it usually is in adjudication

²⁴ This was the second issue considered by the Court of Appeal in *Harbour Assurance v Kansa*.

agreement, encompassing only “disputes under the contract”, the adjudicator has no jurisdiction to consider such a contention.²⁵

There is, however, an emerging line of case law, concerned with the availability of transaction set-off (which includes equitable set-off) in arbitral proceedings; a transaction set-off being a cross claim arising out of the same transaction or one so closely related, such that it operates in law or equity as a complete or partial defeasance of (defence to) the claimant’s claim. The availability of such a set-off as a defence in arbitral proceedings is problematic, however, when it arises out of a related transaction that does not contain an arbitration clause, or, if it does, is one under which the arbitrator is not appointed.²⁶

The formative authority is the Court of Appeal decision *Exnar BV v Aectra Refining & Marketing Inc.*,²⁷ in particular Hoffmann J.:

“In the case of transaction set-off, the authorities are in favour of allowing the set-off to be pleaded, notwithstanding its submission to arbitration or a different jurisdiction. *Gilbert-Ash (Northern) Ltd. v. Modern Engineering (Bristol) Ltd* [1974] AC 689 concerned the question of whether a *Mondel v. Steel* abatement for defective work could be pleaded as a defence to a claim by a builder for payment under an architect’s certificate. The House of Lords decided that it could, notwithstanding that the contract provided for arbitration on the question of whether the work was defective. Lord Diplock (at page 720) said that the contractor could apply for the stay of his own action pending arbitration but if he did not, ‘the court would have to decide on the evidence adduced before it whether the defence was made out.’ Lord Salmon said (at page 726) that it would ‘emasculate’ the right of set-off if the courts were to say to the defendant ‘Pay up now and arbitrate later.’ Likewise in *Meeth v. Glacetal S.a.r.l.* [1978] E.C.R. 2133 the European Court decided that a German buyer of glass, sued for the price in a German court by the French seller, could plead a set-off for delays and defaults by the seller notwithstanding a choice of jurisdiction clause valid under Article 17 which said that each party could be sued only in his own jurisdiction.

In cases of transaction set-off, this obviously makes good sense. *Mondel v. Steel* is, as Lord Diplock (at page 717) emphasised in the *Gilbert-Ash* case, ‘no mere procedural rule designed to avoid circuity of action but a substantive defence at common law’. The same is true of set-off in equity. The defendant is pleading a confession and avoidance to the plaintiff’s claim. He is saying that although the facts alleged by the plaintiff entitle him to judgment for the amount claimed, a wider examination of related facts would show that the claim is wholly or partly extinguished. It would

²⁵ *Ashville Investments v Elmer Contractors*. Controversially, the Court of Appeal also held, in *Fiona Trust & Holding Corp v Yuri Primalov* that, at any rate in an international commercial contract, the words “arising under a contract” should no longer be given a narrower meaning than the words “arising out of a contract” and both should cover every dispute except a dispute as to whether there was ever a contract at all. If, this is upheld by the House of Lords in the forthcoming appeal, it is difficult to envisage that such a change in the law will not, in due course, impact on the interpretation of dispute resolution clause in other types of contract.

²⁶ The problem was considered some years ago by the author, in P. Aeberli, ‘Abatements, Set-Offs and Counterclaims in Arbitration Proceedings’ (1992) 3 *Arbitration and Dispute Resolution Law Journal* 130.

²⁷ [1994] 1 W.L.R. 1634, 1650 *et seq.*

be quite unreasonable for a plaintiff who has chosen to sue in one forum to rely upon an arbitration or jurisdiction clause to confine the court to the facts which he chooses to prove and prevent it from examining related facts as well.”

Although the concern in that case, and in the subsequent case *Glencore Grain Ltd v Argos Trading Co*,²⁸ in which similar principles were enunciated, was the availability in court proceedings of set-offs arising from contracts over which the court did not have jurisdiction because, for example, disputes under those contracts were subject to arbitration; what is sauce for the goose is sauce for the gander. Thus in *Ronly Holdings Ltd v JSC Zestafoni etc.*²⁹ Gross J. considered obiter, whether an arbitrator had jurisdiction to determine a defence of set-off based on a claim arising under a separate contract, saying:

- i) Questions of some intricacy arise as to the classification of set-offs and the correct approach to be followed when a claim before an arbitrator is met by an argument that there is a set-off available arising under some separate transaction over which the tribunal does not have jurisdiction. Provisionally, I would be minded to think that an arbitrator does or should have jurisdiction to allow a ‘transaction’ set-off, in effect amounting or akin to a defence, to be raised to reduce or extinguish a claim, even though that set-off arises under another contract, outside the tribunal’s jurisdiction: see: *Aectra Refining*, at pp. 1648 and following and *Glencore v Agros*, at pp. 416–417, both supra. As it seems to me, the investigation and determination of the availability and amount of such a set-off do not involve the arbitrator arrogating to himself a jurisdiction over separate contracts which he does not have (albeit that considerations of issue estoppel may well arise); instead, these steps form part of the process of arriving at a conclusion of whether a defence is properly available in respect of the contract as to which the arbitrator alone has jurisdiction. However, all these observations are provisional only, given that for reasons which follow, such questions do not arise for decision in this matter.
- ii) Where a decision is called for in respect of a set-off said to arise under a separate contract, then, absent agreement: (1) the point must be properly in issue before the arbitrator; (2) the arbitrator must necessarily investigate the position prevailing in respect of that separate contract; (3) if need be (and unless the arbitrator is proceeding by way of interim award, for example pending a decision on the separate contract by another court or tribunal and with an appropriate reservation of jurisdiction) the arbitrator must make a determination as to the position prevailing in respect of that separate contract; (4) in the light of any such determination, the arbitrator must come to a conclusion as to whether the alleged set-off is indeed available or whether, if not a transaction set-off, it faces a procedural bar, of the nature discussed in the two authorities referred to above.”

²⁸ [1999] 2 Lloyd’s Rep. 410 (CA).

²⁹ [2004] EWHC 1354 (Comm), [33]. See also *Metal Distributors (VK) Ltd v ZCCM Investment Holdings Plc* [2006] EWHC 156 (Comm), [17]ff.

These principles are directly relevant where a set-off based on claims based on different but closely related contract are included in an effective notice of withholding to a payment claimed under a contract. The more interesting question is, however, whether similar principles apply to other defences which, prima facie, do not come within an adjudicator's jurisdiction, if acting under a narrowly worded adjudication clause; for example, defences based on avoiding a contract for misrepresentation or, as in *Capital Structures v Time & Tide*, duress. If so then, when relied on as a defence in adjudication, the adjudicator should investigate and determine the availability of that defence and does not act without jurisdiction by doing so.

The position of settlement agreements set up in defence of claims, is also more problematic than suggested in *Shepherd Construction Ltd v Mecright Ltd*.³⁰ In that case a claim in adjudication for payment under a contract was met by a defence that the claim had been compromised by a settlement agreement, the validity of the settlement agreement then being disputed on the grounds of duress. H.H. Judge Humphrey Lloyd Q.C. held that the settlement agreement extinguished the contractual right to payment. There could be no dispute about what had been of subject to the settlement until and unless a court or arbitrator declared that the settlement was avoided on the grounds of economic duress. This was, something that the adjudicator had jurisdiction to determine, since disputes concerning the settlement agreement did not arise under the contract in respect of which the adjudicator was appointed, but, applying analogous principles to those applicable to transaction set-off, it could be said that, although the adjudicator has no jurisdiction over the settlement agreement, he should, because it is relied on as a defence to the claim, investigate and determine the availability of that defence, which then brings in the duress point, and has jurisdiction to do so. If this is wrong, and the adjudicator has no jurisdiction to consider the settlement agreement as a defence to the claim, he should allow the claim since there is no defence to the claim. The judge in *Shepherd v Mecright* seeks to avoid this somewhat inconvenient result by saying that there can be no dispute about what had been extinguished by the settlement agreement. But why not, if the claim is denied, there is a dispute that can be referred to adjudication. The settlement agreement does not prevent there being a dispute, rather it is the basis on which the claim is disputed. Moreover, the Judge's reasoning rather begs the question of how, if the adjudicator has no jurisdiction to consider the settlement agreement, that reasoning can provide basis for him to dismiss the claim.

Conclusions

The restricted interpretation of the word "dispute" and the black bag theory of adjudication have no place in adjudication law or practice and should be laid to rest. The adducing of new facts and arguments during the course of an adjudication raises procedural problems that have to be managed fairly by the adjudicator. Unless such material includes new claims for relief, not encompassed by the dispute characterised by the notice of adjudication, it will not, ordinarily, give rise to jurisdictional issues. There are, however, unresolved questions as to an adjudicator's jurisdiction to consider allegations that, although they cannot be said to arise "under the contract on" which he is appointed, are relied on as a defence to a claims that do arise under that contract.

³⁰ [2000] B.L.R. 489.