

Construction Law Update

Insolvency and Adjudication: Clarity from the UK Supreme Court

In the case of *Bresco Electrical Services Ltd (In Liquidation) v Michael J Lonsdale (Electrical) Ltd*, the UK Supreme Court (the “UKSC”) considered important questions about the operation of two statutory regimes; namely, adjudication and insolvency set-off. In particular, the UKSC clarified the legal position in respect of situations where there are cross-claims between parties to a construction contract and one of those parties is in liquidation. In simple terms:

Adjudication was introduced as a statutory regime by the Housing Grants, Construction and Regeneration Act 1996, and gives the parties to a construction contract the right to refer disputes to an adjudicator for a speedy decision.

Insolvency set-off under the Insolvency Rules makes provision for automatic set-off of cross-claims between a company in liquidation and each of its creditors, giving rise to a single net balance between them, to be ascertained by the taking of an account.

BACKGROUND

On 21 August 2014, Lonsdale engaged Bresco to carry out electrical installation works at St James’s Square in London (the “Contract”). In December 2014, Bresco ceased to attend the site and subsequently went into creditors’ voluntary liquidation in March 2015.

In late 2017, both Bresco and Lonsdale made claims against one another for breach of the Contract. Both Bresco’s claims and Lonsdale’s cross-claims arose under the Contract. In June 2018, Bresco served a notice of adjudication on Lonsdale, claiming that Lonsdale had wrongfully repudiated the Contract and that certain sums were due to Bresco from Lonsdale.

Lonsdale commenced Part 8 proceedings in the Technology and Construction Court (the “TCC”) seeking an injunction preventing the adjudication from continuing. The TCC held a company in liquidation

could not refer a dispute to adjudication seeking further sums from the responding party. Accordingly, the adjudicator did not have jurisdiction and the injunction was granted.

On appeal to the Court of Appeal, Bresco succeeded on jurisdiction but the injunction restraining the conduct of the adjudication was continued on the basis that, since there could be no enforcement of the award, it would be an exercise in futility and a waste of both time and money.

In the case before the UKSC, Bresco appealed against the continuation of the injunction, whilst Lonsdale cross-appealed on jurisdiction.

THE ISSUES

Jurisdiction

In respect of the cross-appeal on jurisdiction, the UKSC noted that it was common ground that the disputed claim referred by Bresco would have been within the adjudicator’s jurisdiction as a dispute under the Contract if Lonsdale had not had a cross-claim qualifying for insolvency set-off. Lonsdale’s submission was that, because of the automatic operation of insolvency set-off, all claims and cross-claims under the Contract ceased to exist and were replaced by a single claim to the balance. Therefore, Lonsdale’s case was that this was not a claim under the Contract but rather a claim under Bresco’s insolvency.

However, the UKSC held as follows:

“the existence of a cross-claim operating by way of insolvency set-off does not mean that the underlying disputes about the company’s claim under the construction contract and (if disputed) the cross-claim simply melt away so as to render them incapable of adjudication.”

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Citing a main facet of the Court of Appeal's reasoning, the UKSC agreed that it would be absurd if a liquidator would be entitled to pursue a company's claims by arbitration but not by reference to adjudication. Accordingly, the UKSC held that there was no reason why the two forums of dispute resolution should be treated differently.

Ultimately, the UKSC dismissed the cross-appeal on jurisdiction.

Futility

The Court of Appeal held there was a "basic incompatibility" between the adjudication process and the insolvency regime meaning it was very unlikely that an adjudicator's decision in favour an insolvent company would be enforced. The Court of Appeal concluded that:

"a reference to adjudication by a contractor in insolvent liquidation, in circumstances where there is a cross-claim, would be incapable of enforcement and therefore an exercise in futility."

The UKSC held that that "trenchant expressions" of the futility of adjudication and alleged incompatibility with insolvency set-off afforded no proper basis for the grant of an injunction to restrain the pursuit of an adjudication.

In the UKSC's view, the starting point, once it was accepted that there is jurisdiction, is that the insolvent company has both a statutory and contractual right to pursue adjudication as a means of achieving resolution of any dispute arising under their construction contract.

There was also no basis to conclude that adjudication is incompatible with the insolvency process and/or the requirement to deal with cross-claims in insolvency by set-off. This was because the process of proof of debt in the insolvency regime shares many of the essential features of adjudication such as "speed, simplicity, proportionality and economy". Further, an

adjudicator's resolution of the construction dispute referred by a liquidator of a company may be of utility to the insolvency process as a whole.

It was therefore no answer to the utility (rather than the futility) of adjudication in the context of insolvency set-off to suggest that the adjudicator's decision is unlikely to be summarily enforceable. There is no reason arising merely from the existence of cross-claims as to why a claim should not be summarily enforced. However, where there is a real risk that summary enforcement of an adjudicator's decision will deprive a party of its right to have recourse to the company's claim as security for its cross-claim, the court will have to be astute to refuse summary judgment.

The UKSC therefore disagreed with the Court of Appeal in respect of the futility argument, allowed the appeal with the result that the adjudication could proceed, and concluded as follows:

"Construction adjudication, on the application of the liquidator, is not incompatible with the insolvency process. It is not an exercise in futility, either generally or merely because there are cross-claims falling within insolvency set-off, and there is no reason why the existence of such cross-claims can constitute a basis for denying the company the right to submit disputes to adjudication which Parliament has chosen to confer."

ANALYSIS

The UKSC has provided clarity on the operation of (and the relationship between) the adjudication and insolvency regimes, ruling that they are not incompatible with one another and, indeed, share many common characteristics.

The UKSC rejected the Court of Appeal's view that there was a basic incompatibility between the two regimes and instead focused on Bresco's statutory and contractual right to adjudication. Ordinarily, it would be inappropriate for the court to interfere with the exercise of such a right.

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It follows that an adjudicator will have jurisdiction in respect of a claim referred by an insolvent party and that the adjudication process is not, contrary to previous decisions, an exercise of futility in the context of insolvency.

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