

The UK Supreme Court Rules on the Availability of Adjudication for Insolvent Contractors

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In *Bresco Electrical Services Ltd (In Liquidation) v Michael J Lonsdale (Electrical) Ltd*,¹ the UK Supreme Court has examined whether the English construction adjudication regime is compatible with the statutory rules regarding insolvency set-off. In a unanimous decision delivered by Lord Briggs, the court has confirmed that:

- the right of a party to refer a dispute under a construction contract to adjudication will continue notwithstanding that one of the parties to the contract is insolvent or that the dispute is affected by insolvency set-off; and
- generally, the court will only interfere with a party's right to refer claims to adjudication in "very exceptional" circumstances.

The interaction between the adjudication and insolvency regimes, and the apparent tension between the enforceability of adjudicator's decisions and the automatic set-off on insolvency, has generated several High Court decisions. This helpful judgment by the Supreme Court upholds the statutory right to adjudicate and clarifies its role where the claimant is subject to insolvency procedures.

BACKGROUND

In August 2014, Bresco entered into a sub-subcontract with Lonsdale to carry out certain electrical works on a site at St James's Square, London (the "Subcontract"). The Subcontract included an express provision for adjudication of disputes arising under it, in compliance with the requirements of section 108 of the Housing Grants, Construction and Regeneration Act 1996.

In March 2015, Bresco went into voluntary liquidation.

¹ [2020] UKSC 25.

Both parties claimed to be owed money by the other. Lonsdale argued that it had incurred £325,000 as costs of completing the works that it said Bresco had abandoned, and Bresco claimed £219,000 in unpaid fees for the work it said it had performed, plus damages for lost profits. Each party's claim arose entirely under the Subcontract.

In 2018, Bresco's liquidators sought to refer its claim to adjudication. Lonsdale responded by commencing proceedings in the Technology and Construction Court, seeking a declaration that the adjudicator (who by that time was already appointed) lacked jurisdiction and an injunction to restrain the adjudication from proceeding any further.

Lonsdale's position was twofold:

First, Lonsdale argued that, as a result of Bresco's insolvency process, under Rule 14.25 of the Insolvency (England and Wales) Rules 2016 ("Rule 14.25"), an insolvency set-off was automatically to be applied, meaning that each party's claim had been cancelled out, leaving only a claim to the net balance of that set-off exercise. Lonsdale said that this claim was not a dispute under the construction contract, so adjudication was unavailable (the "jurisdiction point").

Second, Lonsdale claimed that adjudication was futile, as an adjudicator's decision in favour of a company in liquidation is not generally enforceable, and so the adjudication would serve no purpose (the "futility point").

At first instance, Fraser J. accepted both of Lonsdale's arguments and granted an injunction to stop the adjudication. Bresco appealed the decision and was successful in having the decision on the jurisdiction point overturned, but the court of appeal upheld the injunction on the basis of the futility point.

Bresco appealed the futility point again to the Supreme Court, and Lonsdale cross-appealed on the jurisdiction point.

THE JUDGMENT

The Supreme Court unanimously dismissed the cross-appeal and allowed the appeal, permitting the adjudication to proceed.

The Jurisdiction Point

The insolvency set-off regime in Rule 14.25 operates automatically upon the commencement of an insolvency process and applies to every type of dealing that the

insolvent company had with third parties prior to the liquidation. Its effect is, for some purposes, to remove existing claims and cross-claims between the company and those third parties and instead to replace them with a single claim for the net balance of those claims and cross-claims. If the net balance is in favour of the company, its liquidator can pursue that sum in the usual ways, through litigation, arbitration or other methods of alternative dispute resolution. If the net balance is in favour of the third party, it must follow the proof of debt process in the liquidation.

Lonsdale argued that the effect of Rule 14.25 was to extinguish the parties' claims and cross-claim under the Subcontract, which severed the connection between the Subcontract and the replacement claim in Bresco's insolvency, such that the agreement to adjudicate no longer applied. Lonsdale advanced several subordinate arguments in support of this position, including that:

- it was inappropriate for the court to take a liberal construction of the adjudication jurisdiction when adjudication is imposed by legislation, rather than freely agreed by the parties;
- the insolvency accounting processes are ill-suited to adjudication; and
- even if the claims under the Subcontract survived the insolvency set-off, the 'single dispute' rule meant that adjudication would not be appropriate to determine Bresco's claims and Lonsdale's cross-claims.

The Supreme Court rejected each of these arguments. Lord Briggs stated that he saw no reason why the fact that the right to adjudicate derived from statute rather than the parties' contract should result in a narrow view on jurisdiction. On the contrary, he held (at [41]):

...the fact that the right to adjudicate is statutorily guaranteed is a powerful consideration favourable both to its recognition as a matter of construction, and to the caution with which the court ought to employ before preventing its exercise by injunction.

The issue of compatibility between adjudication and the rules of insolvency set-off was addressed in Lord Briggs' decision on the futility point (discussed below).

The argument based on the 'single dispute' rule was considered misconceived. Lord Briggs said that nothing in the relevant legislation precludes an adjudicator from determining more than one dispute, provided the issues fall within the referring party's reference, and equally, nothing in the law of insolvency set-off restricts a liquidator from isolating certain disputes to be dealt with separately by way of adjudication.

The Supreme Court therefore dismissed Lonsdale’s cross-appeal on the jurisdiction point. In particular, it held that, although Rule 14.25 prevents certain actions with respect to contractual claims that arose before the liquidation, it does not extinguish those claims or replace them with a new statutory claim. Rights ancillary to those claims, such as a right to have disputes determined by adjudication or arbitration, are therefore retained.

The Futility Point

Lord Briggs explained that the correct starting was that (at [59]):

Injunctive relief may restrain a threatened breach of contract but not, save very exceptionally, an attempt to enforce a contractual right, still less a statutory right.

He held that this high threshold for restraining Besco’s right to require adjudication had not been overcome in this case.

Lord Briggs said that, although it should be recognised as an important underlying objective, it is wrong to suggest that the only purpose of construction adjudication is to protect cash flow and promote a “pay now, argue later” approach to dispute resolution. Adjudication of construction disputes is a time- and cost-effective method of ADR that is an end in its own right, irrespective of the availability of summary enforcement, and is not incompatible with the insolvency process.

Lord Briggs continued to say that the adjudication and insolvency regimes were not incompatible. He noted:

- adjudication shares many attractive features with the proof of debt process in insolvency in terms of “*speed, simplicity, proportionality and economy*”;
- a professional construction expert adjudicating claims and cross-claims is in a better position to resolve such disputes than company liquidators, and the adjudicator’s decision will be of real utility to liquidators conducting the arithmetical set-off for disputed cross-claims within the wider insolvency process; and
- summary enforcement of an adjudicator’s decision will be available in some cases, but even where it is not that does not render the adjudication process futile as the decision can still assist liquidators, and in any event any limit on the enforceability of an adjudicator’s decision is an issue best dealt with at the enforcement stage, rather than by preventing the adjudication from taking place.

Accordingly, the Supreme Court allowed Besco’s appeal on the futility point and discharged the injunction to allow an adjudication to go ahead.

COMMENT

Lord Briggs’ judgment provides clear guidance on the purpose of adjudication, championing it as an attractive, mainstream method of alternative dispute resolution, even for insolvent parties. He confirmed the court’s reticence to interfere with a party’s right to pursue its claims through adjudication.

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