ADJUDICATION, LIQUIDATION AND THE SUPREME COURT

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A recent Supreme Court decision has unanimously upheld the right of companies in liquidation to commence adjudication proceedings: ***Bresco Electrical Services Ltd (In Liquidation) v Michael J Lonsdale (Electrical) Ltd*** [2020] USC 25. This reverts to the position in 2018 before the first instance decision which had allowed an injunction preventing a party in liquidation from bringing an adjudication. This is important because many construction disputes are resolved by adjudication and given the economic consequences of COVID-19, sadly more construction companies are likely to become insolvent and insolvency practitioners will look to ways to realise value for creditors. The proceedings in both Bresco and Meadowside (see below) were pursued by a third party who had entered into an arrangement with the liquidator to either assign the claim or fund the claim in exchange for a share of the proceeds.

This case addressed the tension between the construction adjudication procedure and the insolvency rules. The key issues were:

1. Whether the effect of the mandatory rules of insolvency set-off deprived the Adjudicator of jurisdiction to decide the claim (the jurisdiction issue); and
2. Whether in any event, the adjudication would be an 'exercise in futility' because the court would never order enforcement of the Adjudicator's award (the futility issue).

THE FACTS

In August 2014, Lonsdale engaged Bresco as an electrical sub-sub-contractor on a project. Bresco stopped works in December 2014 and both parties alleged that the other had committed a repudiatory breach. Bresco went into voluntary liquidation in March 2015. Lonsdale's claim against Bresco was for damages for repudiatory breach including the cost of a replacement sub-sub-contractor. Bresco's claim was for monies for works carried out and damages for repudiatory breach.

The Liquidator for Bresco started adjudication proceedings in June 2018 in relation to its claim that Lonsdale was in repudiatory breach. After being unable to persuade the adjudicator to resign for lack of jurisdiction, Lonsdale commenced proceedings in the Technology and Construction Court (TCC) seeking an injunction restraining the adjudication and declarations that there was (i) no jurisdiction and (ii) any decision would be unenforceable. Lonsdale argued that the claim and cross claim had

been cancelled out by the process of insolvency set off which meant there was no dispute under the contract so the adjudicator had no jurisdiction. They also said that an adjudication would be futile because any decision would not be enforced until the liquidator had calculated the net balance.

THE APPROACH OF THE COURTS

At first instance, in July 2018, Fraser J in the TCC agreed with Lonsdale and gave the injunction to restrain the adjudication proceedings for two reasons. (1) The adjudicator did not have the necessary jurisdiction to deal with a claim advanced by a company in insolvent liquidation. (2) Any adjudicator's decision in favour of a company in insolvent liquidation would not be enforced by the courts.

The case was appealed to the Court of Appeal in 2019. The leading judgment was given by Coulson LJ (former judge in charge at the TCC). He decided that it was wrong for Fraser J to find that the adjudicator had no jurisdiction to decide the claim and that Bresco's right to refer a dispute to adjudication was not lost when they went into liquidation. However, he considered that it was just and convenient to grant an injunction because an adjudicator's decision in favour of a company in liquidation was not capable of being enforced and as such the adjudication was an "exercise in futility".

This was appealed and cross appealed by the parties to the Supreme Court. The judgment in the Supreme Court was given by Lord Briggs on 17 June 2020.

THE JURISDICTION POINT

Many construction disputes are resolved by adjudication. Adjudication is an interim binding and speedy method of dispute resolution. Section 108 of the Construction Act[i] provides that a party to a construction contract has the right to refer a dispute arising out of the contract to adjudication at any time. Most construction contracts include an express term to this effect.

It is interim binding because it can be finally determined by court proceedings, arbitration or agreement. The approach is 'pay now, argue later'. An adjudicator's decision can be enforced promptly using a summary judgment process in the TCC. An adjudicator's decision can only be challenged on if there is no jurisdiction or a breach of natural justice.

Rule 14.25 of the Insolvency Rules 2016[ii], provides for mandatory and automatic insolvency set off between a company in liquidation and its creditors. This replaces individual debts under individual contracts with a single right to claim the net balance arising out of the mutual dealing between the parties. If any of the claims or cross-claims are in dispute these first need to be resolved before the net balance can be identified. This process, by submission of proofs of debt shares some features of adjudication i.e. interim binding nature.

Lonsdale's argument was that since insolvency set off replaced the former cross claims with a single claim for the net balance there was no longer a dispute under the construction

i Housing Grants, Construction and Regeneration Act 1996

ii SI 2016/1024

contract so the adjudicator lacked jurisdiction.

The Supreme Court emphatically held that construction adjudication was not incompatible with the insolvency code or insolvency set off. It made it clear that the operation of the insolvency set off did not mean that the underlying disputes under the construction contact melted away and were replaced by a dispute in insolvency. It also agreed with Coulson LJ in the Court of Appeal that if a liquidator was entitled to pursue the company's claims by arbitration then there was no reason to treat adjudication differently.

THE FUTILITY POINT

Both the TCC and the Court of Appeal had agreed that an adjudication would be pointless and that Lonsdale's cross claim would prevent the court ordering summary judgment to enforce the decision.

This was the basis on which the Court of Appeal considered it was just and convenient to grant an injunction. Alternatively, the fact of the liquidation would mean that the court would order a stay against enforcement. Coulson LJ said it would only be "exceptional circumstances" where a company in liquidation could obtain summary judgment and avoid a stay of execution. He set out a number of policy decisions to prevent futile adjudications including (i) participation in adjudication would involve the waste of limited financial resources by the liquidator; (ii) expose the respondent to wasting costs in a futile process, where there would be no basis of recovering them even if successful; (ii) the respondent would, if the liquidator obtained summary judgment for an excessive amount, have to spend further costs on court proceedings to rectify the position, with doubtful recovery from the company even if successful; and (iv) the pursuit by liquidators of adjudication followed by enforcement would put undue pressure on the TCC, to the detriment of solvent court users.

The Supreme Court disagreed. If the company in liquidation has the right to adjudicate then it is inappropriate for the court to interfere and grant an injunction simply because they are in an insolvency process and there are cross claims which trigger insolvency set off. It went on to make clear that summary enforcement

may or may not be appropriate but that it was for the court to deal with at the enforcement stage. The court can refuse summary judgment in an appropriate case as a matter of discretion or grant it with a stay of execution. At least at that stage the merits are known. But there is no need for an injunction or to prevent the adjudication from running its speedy course, which would likely be resolved before any opposed injunction application at less cost.

ENFORCEMENT

The Supreme Court decision paves the way for liquidators to commence adjudications, so the real battle ground will become the enforcement proceedings if the solvent party is unhappy with the decision.

In this regard, the Supreme Court referred to the decision of the TCC in ***Meadowside Building Developments Ltd (in liquidation) v 12-18 Hill Street Management Company Ltd*** (2019) which considered what would be "exceptional circumstances" where a company in liquidation would be permitted to enforce an adjudication decision. In this case summary judgment was refused but the judge in that case held that likely to be exceptional circumstances where:

(i) The adjudication determines the final net position between the parties under the relevant contract; and

(ii) Satisfactory security is provided in respect of any sum awarded in the adjudication decision and any adverse costs orders i.e. ring fencing the sums by liquidator, bank guarantee or bond, payment into court and after the event (ATE) insurance.

The decision in Meadowside was followed in ***Balfour Beatty Civil Engineering Ltd v Astec Projects*** (2020). The court refused to grant an injunction to restrain three adjudications relating to three sub-contracts on the same project. It fell within the exceptional circumstances envisaged by the Court of Appeal in ***Bresco v Lonsdale***. If there were three adjudications and each produced a net result in favour of one of the parties this would determine the final net position between the parties. There was also a satisfactory offer for security for costs. The court required that the three adjudications be heard by the same adjudicator and some amendments required to the ATE insurance policy.

SUMMARY

It is clear that there will be more adjudications commenced by liquidators of construction companies and that responding parties will be unlikely to successfully argue that there is no jurisdiction. The courts are also unlikely to grant an injunction to restrain the proceedings. However, the issue remains whether a court is likely to enforce the adjudication award in any event and whether the rigorous requirements in Meadowside for security will apply.

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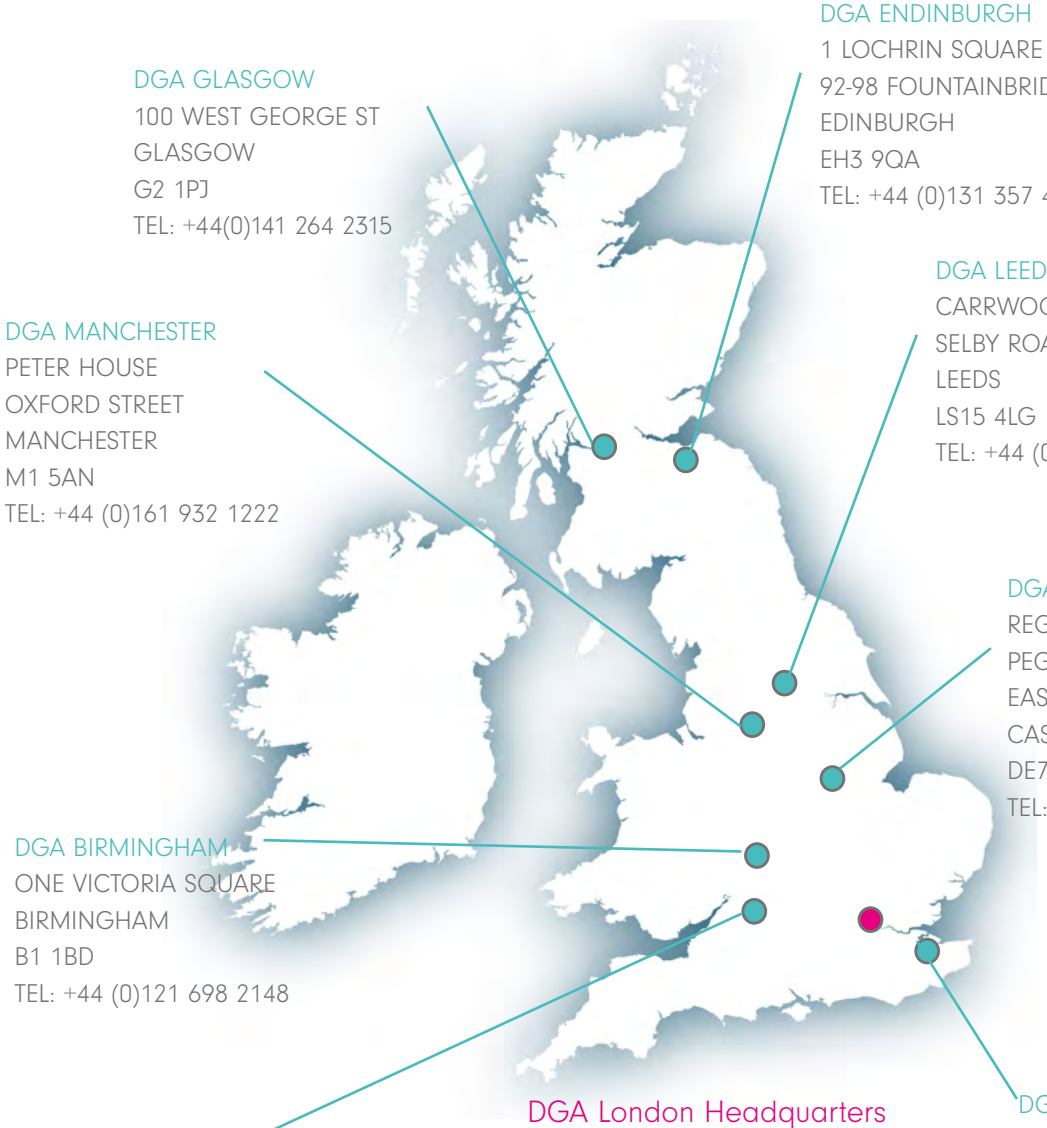

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