Adjudication Update: Bresco Electrical Services Ltd (In Liquidation) v Michael J Lonsdale (Electrical) Ltd

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Introduction

The Supreme Court has recently handed down judgment in the case of ***Bresco Electrical Services Ltd (In Liquidation) v Michael J Lonsdale (Electrical) Ltd (2020) UKSC 25***. This decision has highlighted the interplay and compatibility between the statutory adjudication regime for construction disputes and the insolvency regime.

Therefore, we have prepared a high-level update on the decision.

Summary

The Supreme Court dealt with two key points at the heart of the appeal being: (a) whether an adjudicator has jurisdiction to decide a case where the referring company is in liquidation and there is a cross-claiming creditor (the "Jurisdiction Point") and (b) even if there is jurisdiction, whether the court should grant an injunction to restrain the company in liquidation from referring a dispute with a cross-claim to adjudication on the grounds that an adjudication would be a futile exercise because the award would generally be incapable of enforcement in these circumstances (the "Futility Point").

In relation to the Jurisdiction Point, the Supreme Court confirmed that the adjudicator has jurisdiction to decide such a dispute. In relation to the Futility Point, the Supreme Court held that even though summary enforcement of an award in these circumstances would frequently be inappropriate or unavailable, the adjudication was not an exercise in futility and an injunction should not be granted.

Statutory Adjudication Regime v Insolvency Regime

The case has highlighted the very interesting tension between two statutory provisions:

a. Section 108 of the Housing Grants, Construction and Regeneration Act 1996 ("the Act"), which confers a right upon a party to a construction contract to refer a dispute arising under that contract to adjudication.

b. Rule 14.25 of the Insolvency (England and Wales) Rules 2016 (SI 2016/1024)), which essentially provides for the set-off of cross-claims between a company in liquidation and a creditor.

The Facts

In this case, pursuant to a contract dated 21 August 2014, Bresco agreed to perform electrical installation works for Lonsdale at 6 St James's Square, London ("the Construction Contract"). The Construction Contract included express provision for disputes to be referred to adjudication which complied with section 108 of the Act.

In December 2014, Bresco ceased to attend the construction site. After some time, Bresco stated that was because they had accepted a repudiatory breach of the Construction Contract by Lonsdale.

In March 2015, Bresco went into creditors' voluntary liquidation.

In late 2017, both Bresco and Lonsdale made cross-claims against each other for damages based on allegations of repudiatory breach of the Construction Contract in correspondence.

In June 2018, Bresco served on Lonsdale notice of intention to refer a dispute to adjudication seeking £219,000 for the value of works done and damages for loss of profit. Lonsdale's response was to assert the adjudicator was without jurisdiction and to seek an injunction.

The High Court agreed with Lonsdale in relation to the lack of jurisdiction point. The Court of Appeal found that the adjudicator had jurisdiction, but that an injunction was appropriate because the adjudication would be an exercise in futility. The decision was appealed to the Supreme Court.

Adjudication

With respect to adjudication, the Supreme Court highlighted several points about adjudication, which are worth reminding ourselves of.

The Act confers a right of a party to a construction contract to refer a dispute under the contract to adjudication.

The Act does not deny the right of a company to refer disputes (with no cross-claims) to adjudication because it is in liquidation.

One of the key objectives of adjudication is to resolve disputes quickly to prevent cash flow problems that could disrupt an entire construction project. However, that was not the sole objective of adjudication, which was designed and proved to be a mainstream dispute mechanism in its own right, which produces de facto final resolution of most of the disputes that are referred to an adjudicator.

Adjudication is a remarkably quick form of dispute resolution, it is almost bound to be cheaper than court proceedings and that despite there being no formal avenue of appeal against an adjudicator's decision in the adjudication process, a dissatisfied party can insist on having the dispute redetermined de novo in court or by arbitration (if available) even though the decision will be binding in the meantime.

Insolvency Set-off

The Supreme Court explained the regime. Rule 14.25 applies automatically to every type of pre-liquidation mutual dealing between the company and creditor of the company. In broad terms, the rule provides that where a company and a creditor both have claims against each other, account must be taken of what is due as a result of all of the company's claims and all of the creditor's claims with the two sums set off against each other such that:

a. If there is a balance owed to the company then that must be paid to the liquidator as part of the assets.

b. If there is a balance owed to the creditor then only that balance is provable in the liquidation.

It is said for some purposes that the original claims are replaced with one claim for the balance.

The Jurisdiction Point

Lonsdale's main submission was that the automatic operation of the insolvency regime to the cross-claims meant that all claims under the Construction Contract had ceased to exist as they had been replaced by a single claim to the balance as part of the insolvency set-off. It was said that meant there was no claim under the Construction

Contract (but rather a claim under Bresco's insolvency) and as such section 108 of the Act was not engaged meaning the adjudicator did not have jurisdiction to hear the dispute.

However, the Supreme Court held that the existence of a cross-claim engaging the insolvency set-off rule does not mean that the underlying disputes under the Construction Contract melt away so as to render them incapable of adjudication. In other words, there was still a dispute under the Construction Contract which engaged section 108 of the Act.

The Supreme Court stated that to suggest, for example, that a company in liquidation which wished to bring an adjudication in relation to a dispute for £300,000 cannot do so if there is an undisputed cross-claim for £25, would be a "*triumph of technicality over substance*".

The Futility Point

Lonsdale's position was that even if there was jurisdiction, the conduct of an adjudication in the context of insolvency set-off will, generally speaking, not lead to an enforceable award and, therefore, be an exercise in futility, which the court can and should restrain by the award of an injunction. The Court of Appeal had agreed with this.

The Court of Appeal had taken the view that there was a basic incompatibility between the statutory adjudication scheme and the insolvency set-off regime. They said that the former was a method of obtaining " *improved cashflow quickly and cheaply*" and the latter was "*an abstract accounting exercise, principally designed to assist the liquidators in recovering assets in order to pay a dividend to creditors*". They also explained that a decision of an adjudicator in favour of a company in liquidation such as Bresco would not usually be enforced by the courts and this was a reason why an injunction should be granted. Typically, that is because an award of an adjudicator will not necessarily be in respect of **all** claims between the parties but only specific claims. Therefore, if a creditor is ordered to pay a sum of money pursuant to an adjudicator's award to a company in liquidation those monies will form part of the fund applicable for distribution amongst the other creditors, Therefore, if the creditor has another valid claim against the company in liquidation it will only receive a dividend pro rata to the amount of its claim having already paid the total value of the adjudicated claim. This issue and other issues were explained by the Court of Appeal in ***Bouygues (UK) Ltd v Dahl-Jensen (UK) Ltd [2001] 1 ALL ER (Comm) 1041***.

Unlike the view of the Court of Appeal, the Supreme Court stated that there was no incompatibility between the statutory adjudication regime and insolvency set-off because the adjudication provided a means of determining the value of certain cross-claims, which could then be subject to a set-off under the insolvency regime.

Furthermore, the Supreme Court agreed that an award in these circumstances may frequently not be enforced by the courts, but disagreed that meant that a party should be prevented from adjudicating a dispute. The Supreme Court held that, in the context of construction disputes, adjudication has become a mainstream method of ADR leading to "*the speedy, cost effective and final resolution*" of disputes and that dispute resolution is "*an end in its own right, even where summary enforcement may be inappropriate or for some reason unavailable*".

Ultimately, the Supreme Court held, even a company in liquidation has a statutory and contractual right to adjudication and it would be ordinarily entirely inappropriate for a court to interfere with the exercise of that statutory and contractual right.

Further Information

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