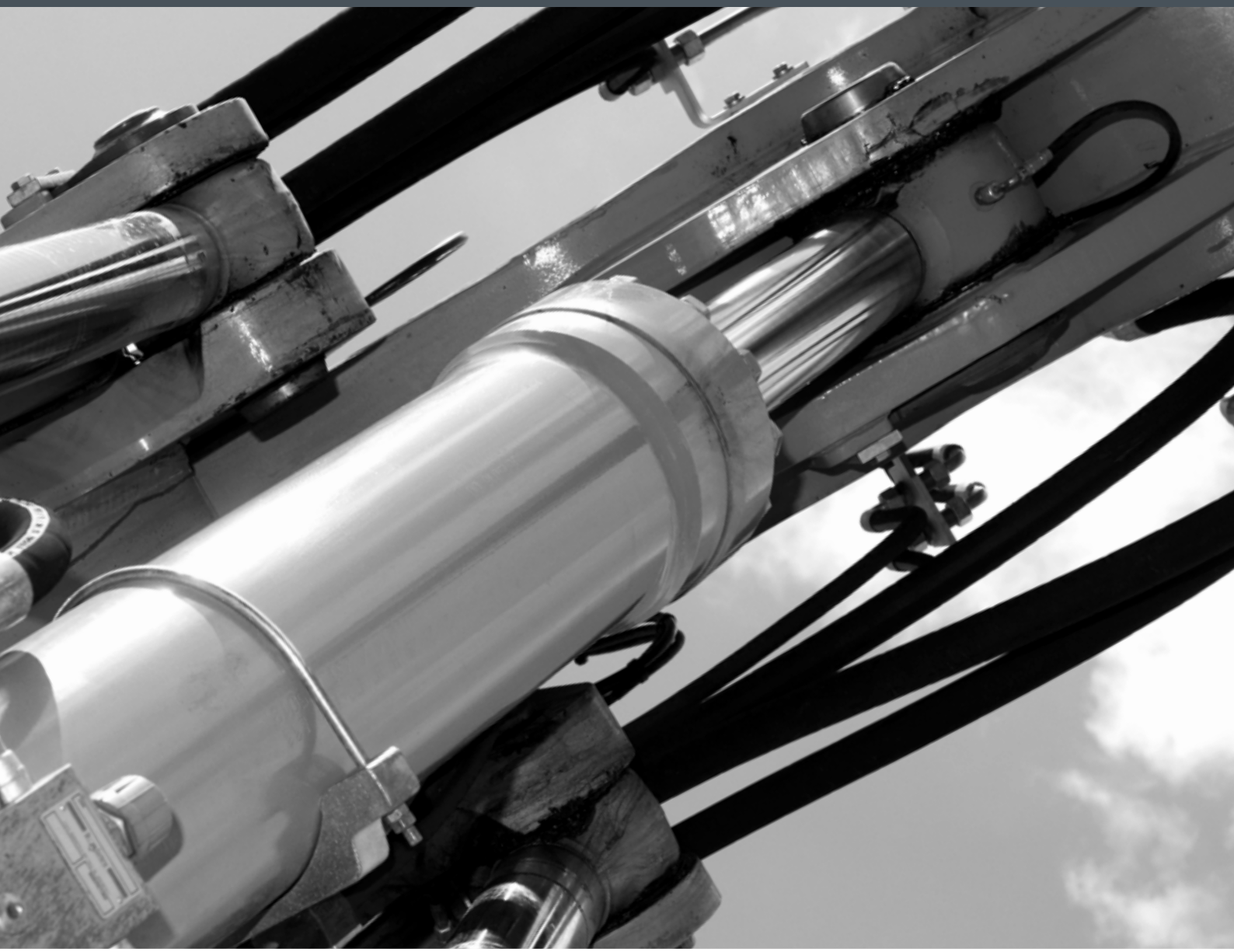

SUPREME COURT BLESSES THE USE OF ADJUDICATION BY INSOLVENCY PRACTITIONERS IN CONSTRUCTION DISPUTES

In a clear and unanimous judgment,[1] the Supreme Court has endorsed the use of adjudication by insolvency practitioners as a means of resolving disputes arising under construction contracts. In doing so, the Supreme Court has provided a timely reminder of the benefits of adjudication in relation to construction disputes more generally.

1 *Bresco Electrical Services Limited (in liquidation) v Michael J Lonsdale (Electrical) Limited* [2020] UKSC 25.

Background

Bresco (a company in liquidation) sought to commence adjudication against Lonsdale in 2018 in respect of disputes arising out of a construction contract entered into between the parties in 2014. In accordance with section 108 of the Housing Grants, Construction and Regeneration Act 1996 (as amended) (the "Construction Act"), the contract contained an express provision for the adjudication of disputes arising under it. However, Lonsdale asserted that the adjudicator had no jurisdiction as a result of the rules on insolvency set-off (a mandatory and automatic set-off of cross-claims between a company in liquidation and each of its creditors arising out of their mutual dealings which gives rise to a single net balance payable to or from the company). Lonsdale therefore sought an injunction restraining the further conduct of the adjudication.

At first instance, Fraser J held that the adjudicator had no jurisdiction. The judge held that due to the rules on insolvency set-off the cross-claims are no longer capable of separate enforcement and are instead replaced with a single debt. He therefore granted an injunction restraining the further conduct of the adjudication.

In the Court of Appeal, whilst it was held that the adjudicator did have jurisdiction to consider the claim (notwithstanding the rules on insolvency set-off), it was nonetheless decided that the two regimes (insolvency set-off and adjudication) were incompatible. As a result, the Court found that as adjudication in the context of insolvency set-off will not lead to an enforceable award it would be an *"exercise in futility"*.[2] The injunction restraining the adjudication proceedings was therefore upheld by the Court of Appeal.

The Supreme Court judgment

The Supreme Court has now handed down its ruling on these matters and provided much needed clarity.

In respect of whether or not an adjudicator has jurisdiction in this context, the Supreme Court agreed with the Court of Appeal and held that it was wrong to say that disputes between the parties about claims and cross-claims under the construction contract are replaced by a single claim for the net balance in the insolvency (due to the mandatory insolvency set-off). The insolvent company therefore *"has both a statutory and a contractual right to pursue adjudication as a means of achieving resolution of any dispute arising under a construction contract to which it is a party"*.[3]

In respect of the futility argument, the conclusion reached by the Supreme Court was that *"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 to the company the right to submit disputes to adjudication which Parliament has chosen to confer"*.[4] In this context, the fact that a Court may decline to enforce an adjudicator's decision does not mean that the adjudication should not be allowed to go ahead; any questions about enforcement of an adjudicator's decision in favour of an insolvent company can be resolved during enforcement proceedings.

Analysis

Insolvency practitioners will welcome the clarity that this judgment brings. It is now clear that a liquidator's power to *"bring or defend any action or other legal proceeding in the name and on behalf of the company"* [5] is not qualified in respect of adjudication proceedings.

As Lord Briggs stated, *"the adjudicator's resolution of the construction dispute referred by the liquidator may be of real utility to the conduct of the process of set-off within the insolvency process as a whole"*.[6] This reflects what has been described as being the *"plain"* intention behind the introduction of adjudication in construction disputes as a *"speedy mechanism for settling disputes in construction contracts on a provisional interim basis, and requiring the decisions of adjudicators to be enforced pending the final determination of disputes by arbitration, litigation or agreement"*.[7]

Adjudication is therefore another useful tool for insolvency practitioners in valuing and resolving claims in the liquidation. As Lord Briggs explained, an insolvency practitioner may *"untangle a complex web of disputed issues arising from mutual dealings between the company and a third party by picking some as suitable for adjudication, others for arbitration and others for disposal by an application to the court for directions, or by ordinary action. At the same time the liquidator may seek to deploy ADR and negotiation to narrow the issues in the meantime"*.[8]

The judgment also serves as a reminder of the benefits of adjudication to insolvency practitioners as a method of resolving construction disputes. Lord Briggs stated that *"the overall picture of most adjudication decisions achieving de facto final resolution of the underlying dispute appears clear"*.[9] More specifically in the context of construction disputes, Lord Briggs explained that *"adjudication has, as was always intended, become a mainstream method of ADR, leading to the speedy, cost effective and final resolution of most of the many disputes that are referred to adjudication. Dispute resolution is therefore an end in its own right, even where summary enforcement may be inappropriate or for some reason unavailable"*.[10]

2 *Bresco Electrical Services Limited (in liquidation) v Michael J Lonsdale (Electrical) Limited* [2019] EWCA Civ 27, per Coulson LJ at para 63.

3 Para 59.

4 Para 71.

5 Paragraph 4 of Schedule 4 to the Insolvency Act 1986. Administrators have a corresponding power in paragraph 5 of Schedule 1 of the Insolvency Act 1986.

6 Para 63.

7 Per Dyson J in *Macob Civil Engineering Ltd v Morrison Construction Ltd* [1999] B.L.R. 93.

8 Para 46.

9 Para 15.

10 Para 60.

“The Supreme Court judgment is clearly an important decision in this area. It confirms that companies in liquidation have the right to use adjudication as a form of ADR to determine construction disputes. ”

Likely implications

The confirmation that an insolvency practitioner has the ability to use adjudication as a means of resolving disputed claims is welcome in light of the likely rise in formal insolvencies in the construction sector given the current economic climate resulting from COVID-19.

The Supreme Court noted that, as with a liquidator’s decisions in respect of proofs of debt in a liquidation, most adjudication decisions are not challenged.[11] Further, as Lord Briggs explained, in many instances *“the adjudicator will be better placed than most liquidators”* to resolve disputes arising under specialist construction contracts.[12] This should in practice mean that the use of adjudication by insolvency practitioners as a tool to determine claims will lead to the swift and cost effective resolution of disputes arising under construction contracts.

However, will it in fact be useful as a recovery tool in the insolvency context? Whilst the decision might immediately seem to imply that such disputes will be resolved more quickly and in a more cost effective manner by an adjudicator with particular expertise, the Supreme Court acknowledged that a responding party may still resist the decision at the enforcement stage.

Further, there could be a rise in the requirement for security from the insolvent company in respect of the amount awarded by the adjudicator and the costs of any subsequent litigation. This will be a mechanism by which the court can ensure that a solvent creditor’s position is protected in that future litigation. In *Meadowside Building Developments Ltd v 12-18 Hill Street Management Company Ltd*,[13] the Court held that enforcement of an adjudicator’s decision in favour of an insolvent company could be permitted provided that *(inter alia)* adequate security was given in respect of both the amount awarded by the adjudicator and also any costs in relation to any subsequent proceedings to enforce or challenge the adjudication decision. A similar decision was reached earlier this year in the case of *Balfour Beatty Civil Engineering Limited & Anor v Astec Projects Limited (in liquidation)*,[14] where the Court refused to grant an injunction restraining adjudication from continuing provided that (among other things) adequate security was provided. This will no doubt also lead to developments in the use of funding in this area.

The Supreme Court judgment is clearly an important decision in this area. It confirms that companies in liquidation have the right to use adjudication as a form of ADR to determine construction disputes. The right to adjudicate at any time granted by the Construction Act remains unfettered.

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11 Para 32.
12 Para 62.
13 [2019] EWHC 2651 (TCC).
14 [2020] EWHC 796 (TCC).

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