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Insolvency and adjudication – an exercise in futility?

A recent decision by the Court of Appeal has confirmed whether companies in liquidation or in a Company Voluntary Arrangement ("CVA") can commence adjudication proceedings.

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Date:
February 2019

The judgment also provides clear guidance on challenges to an adjudicator's jurisdiction, which is of importance to all involved in adjudications.

Background

The case concerned two conjoined appeals, *Bresco Electrical Services Limited (in liquidation) v Michael J Lonsdale (Electrical) Limited* and *Cannon Corporate Limited v Primus Build Limited*.

Bresco

On 21 August 2014, Michael J Lonsdale (Electrical) Limited ("Lonsdale") and Bresco Electrical Services Ltd ("Bresco") entered into a sub-contract for the provision of electrical installation works. The works fell under the scope of the Housing Grants Construction and Regeneration Act 1996 ("the Construction Act").

Bresco left the site in December 2014 before completion of the works, leading to both Bresco and Lonsdale alleging wrongful termination. Subsequently, Bresco became insolvent and in 2015 went into liquidation.

In October 2017, Lonsdale issued proceedings against Bresco, claiming the costs of completing the works after Bresco left the site. In response, Bresco's liquidator alleged that Lonsdale had wrongfully terminated the contract and so owed Bresco money.

On 18 June 2018, Bresco (through its liquidator) issued a notice of adjudication. Lonsdale raised a jurisdictional challenge on the basis that, as Bresco was now insolvent, the financial relationship between the parties would be governed by the set-off provisions of the Insolvency (England and Wales) Rules 2016 ("the Insolvency Rules").

Very broadly, the Insolvency Rules create a mandatory set-off that takes effect automatically upon a company entering liquidation. This means that mutual dealings between the insolvent company and its creditor are set-off, so that only the net balance is provable in the liquidation. This set-off exception gives the creditor a full recovery of that balance – without the exception, the creditor would be obliged to pay the full amount alleged to be owing to the insolvent company, while only being able to claim in the liquidation for a portion of its own claims on an equal footing with all other creditors. In many instances, the assets of the insolvent company are minimal, meaning that the creditor may well receive less from its claim in liquidation than it had to pay in.

With that in mind, the adjudicator declared he did have jurisdiction to determine the dispute. Lonsdale then issued Part 8 proceedings in the High Court seeking declarations and an injunction to prevent the adjudication from proceeding.

At first instance, Mr Justice Fraser concluded that the adjudicator did not have jurisdiction (as discussed in our article here), and granted an injunction. The TCC found that an adjudicator cannot determine the net balance created by mandatory set-off because this does not fall under an adjudicator's jurisdiction granted under the Construction Act but instead under the Insolvency Rules.

Bresco appealed.

Primus

In relation to the second appeal, on 5 May 2015 Cannon Corporate Limited ("Cannon") entered into a contract with Primus Build Limited ("Primus") to design and build a new hotel in London.

On 26 July 2016, Primus served a Payment Notice on Cannon in the sum of £261,222.17, which led to Cannon serving a Pay Less Notice in response. By 11 August 2016, Cannon served a notice of termination, leading to Primus leaving the site. Each side alleged that the other was in repudiatory breach of contract.

A series of adjudications followed. At the end of the second adjudication on 2 November 2016, the adjudicator found that Cannon was in repudiatory breach of contract.

On 10 January 2017 Primus issued court proceedings in the High Court claiming damages for Cannon's repudiatory breach of contract and the unpaid sum due arising from the subsequent third adjudication (which was not relevant to the issues under appeal here). Primus obtained a freezing order up to the value of £75,000 on a without notice basis.

On 27 July 2017 Primus entered into a CVA on the basis that, although the company was currently insolvent, there was a strong likelihood that they would recover significant sums of money from various third parties including Cannon, satisfy all creditors, and be able to continue trading fully. Unlike liquidation, a CVA allows a company to continue trading throughout the duration of the CVA, as it proposes an arrangement for the payment of its debts. However, the same set-off under the Insolvency Rules applies.

On 18 March 2018, Primus referred to adjudication (the fourth adjudication) its claim for damages caused by Cannon's repudiatory breach of contract, as found by the adjudicator in adjudication 2 (2 November 2016). A different adjudicator identified a net sum due to Primus of £2.128 million plus interest. In arriving at that sum the adjudicator almost entirely rejected various cross-claims raised by Cannon.

Primus then commenced enforcement proceedings in the High Court in May 2018 to enforce the adjudicator's decision in the fourth adjudication (ie. the £2.128 million). Cannon initially agreed in writing that summary judgment could be entered against it. It later changed its mind and sought a stay of enforcement.

At first instance, HH Judge Waksman QC considered the principles in *Wimbledon Construction Co 2000 Ltd v Vago* [2005] EWHC 1086 (TCC), and concluded that a stay should not be granted because Primus' financial position was due significantly to Cannon's refusal to pay.

Cannon did not raise the fact that Primus had entered into a CVA as a jurisdictional issue at the time of the fourth adjudication or at the subsequent enforcement proceedings.

Court of Appeal

Starting with the *Bresco* appeal, the Court of Appeal upheld the injunction against Bresco.

The Court found there was a basic incompatibility between the set off provisions under the Insolvency Rules and adjudication. Contrary to the TCC's first-instance finding, Coulson LJ (delivering the Court of Appeal's judgment) found that, in principle, despite the fact that an underlying debt is replaced by a net balance under the Insolvency Rules, an adjudicator would have the same jurisdiction as a court or an arbitrator (who do have jurisdiction to decide such matters). In short, the Court found an adjudicator does have jurisdiction to consider a claim referred by a company in liquidation.

Although there is no technical bar to the adjudicator's jurisdiction where a company is insolvent that does not mean the process should continue to completion. Where there is a claim and a cross-claim, it is unlikely that the insolvent referring party will recover anything. By contrast, the responding party would incur costs dealing with an adjudication (which is cost-neutral), when the referring party had no real prospect of success. Coulson LJ concluded that a solution would be to grant an injunction to prevent the adjudication taking place and the opposing party from wasting costs.

In the Bresco appeal, the fact that Bresco had been in liquidation for three years and that Lonsdale had a genuine cross-claim meant that it would be neither just nor convenient for the adjudication to continue, and the injunction was upheld.

In relation to the *Cannon* appeal, Coulson LJ stated that there are important differences between a company in liquidation (such as Bresco) and a company in a CVA (Primus). In rejecting Cannon's argument that there was a "compelling reason to refuse summary judgment", the Court confirmed that Primus' CVA was not relevant when considering whether or not to grant a stay. This is because the CVA allowed Primus to try trade its way out of difficulties and, if successful, it would mean Primus avoided liquidation. The expedited adjudication process could be a quick (and cost-neutral) tool to try improve the company's cashflow, and complete the CVA process. Primus was therefore entitled to summary judgment arising from the adjudication.

Although not strictly relevant to the above (particularly since *Cannon* settled between the time the case was argued and the Court delivering judgment), it is worth noting that Coulson LJ considered that Cannon should have raised the jurisdictional argument that Primus had entered into a CVA at the outset of the fourth adjudication or in the first instance proceedings before the High Court. The Court of Appeal therefore took this opportunity to provide guidance on how a party can effectively reserve its position to challenge an adjudicator's jurisdiction.

First, a jurisdictional challenge/reservation must be made in clear and precise terms prior to the adjudication taking place. If a party participates in the adjudication and does not reserve its position, it will have waived any jurisdictional objection and will be unable to avoid enforcement on jurisdictional grounds.

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Secondly, if a specific challenge to jurisdiction is rejected by the adjudicator and by the court if raised again on enforcement, the party challenging jurisdiction cannot later raise a different jurisdictional challenge. It is advisable for a party to rely on a specific objection to reserve its position, as otherwise, neither an adjudicator or a referring party can assess the merits of the objection.

Finally, a general reservation of position on jurisdiction is undesirable but can be successful depending on the wording of the reservation. A general reservation may not be effective if, at the time it was provided, more specific objections were known but not mentioned, or it appeared that the general reservation was worded in a way to try and keep all options open (even those not thought of at the time).

Comment

In terms of the interplay between the Insolvency Rules and adjudication, the judgment confirms that the courts (and adjudicators) will distinguish between a referring party in liquidation and a company in a CVA. Although the right to refer a dispute to adjudication is not automatically lost when a company enters liquidation, the incompatibility between the adjudication and insolvency regimes means that where there is a genuine cross-claim it is likely that an injunction will be granted to the responding party, on the basis that the adjudication lacks any real utility. For completeness, the judgment does not deal with a situation where a responding party is insolvent – different rules apply then.

As for jurisdictional reservations, this is something that all parties involved in adjudications should be aware of, regardless of whether the referring party is solvent or insolvent. Such reservations are made in almost every adjudication. The judgment highlights the importance of reserving jurisdictional rights in adjudications as soon as possible and, where possible, making them specific. Although Coulson LJ stressed that specific reservations are favoured, in some circumstances a general reservation of rights might still be effective. However, this can be a dangerous gamble – doing so runs the risk of an adjudicator (or a court on enforcement) finding that the reservation was so vague as to try keep all options open, and refuse to accept it as being valid

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