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

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Synopsis

The Supreme Court has endorsed the use of construction adjudication by insolvent companies in the much-anticipated case of *Bresco Electrical Services Limited (in liquidation) v Michael J Lonsdale (Electrical) Limited*.[1] The decision overturns Coulson LJ's decision in the Court of Appeal.[2]

The Supreme Court was asked to consider the compatibility of two statutory regimes:

– the right to adjudication of disputes arising out of a construction contract under s.108 of the Housing Grants, Construction and Regeneration Act 1996 (the '1996 Act');[3] and

– the operation of insolvency set off under Rule 14.25 of the Insolvency (England and Wales) Rules 2016 (the 'Insolvency Rules').[4]

The Supreme Court did not grant an injunction to restrain the adjudication, but instead held (i) that an adjudicator has jurisdiction to decide a claim in circumstances where insolvency set off applies, and (ii) the insolvency of the referring party was not relevant to the utility of the adjudication.

The facts

Bresco entered into a sub-sub contract with Lonsdale in August 2014 to perform electrical installation works. The contract was a construction contract governed by the 1996 Act. Bresco left the site in December 2014, and each of Bresco and Lonsdale subsequently alleged wrongful termination against the other. In March 2015, Bresco entered into creditors' voluntary liquidation.

In correspondence in late 2017, both Bresco and Lonsdale alleged claims against the other for breach of contract. Lonsdale claimed for the costs of another contractor completing Bresco's works (amounting to GBP 325 000). In June 2018, Bresco served an adjudication notice on Lonsdale seeking GBP 219 000 for non-payment of the value of work that it had completed and damages for loss of profits. Lonsdale's cross-claims were not referred to the adjudicator.

Lonsdale issued proceedings in the Technology and Construction Court (TCC) for a declaration that the adjudicator lacked jurisdiction and an injunction restraining the further conduct of the adjudication, arguing that:

1. The automatic application of insolvency set off resulted in the cross-claims being replaced by a single claim for the net balance under the Insolvency Rules at the point of Bresco's liquidation. As a result, Bresco's claim under the construction contract ceased to exist, such that there was no dispute over which the adjudicator had jurisdiction.
2. Even if the adjudicator had jurisdiction, an adjudication decision in favour of a company in liquidation will generally not be enforced by the courts and would therefore be an exercise in futility which the court can and should restrain by injunction to avoid wasted costs.

The High Court

The case was heard at first instance in the TCC by Fraser J.[5] He considered the leading cases on insolvency set off, including Lord Hoffman's seminal judgment in

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1 [2020] UKSC 25.
2 [2019] EWCA Civ 27.
3 Section 108 of the Housing Grants, Construction and Regeneration Act 1996 provides that 'a party to a construction contract has the right to refer a dispute arising out of the contract for adjudication'.
4 Rule 14.25(2) of the Insolvency Rules 2016 provides that 'an account must be taken of what is due from the company and the creditor to each other in respect of their mutual dealings and the sums due from the one must be set off against the sums due from the other.'
5 [2018] EWHC 2043 (TCC)

Stein v Blake[6] and Coulson J's (as he then was) judgment in *Enterprise Managed Services Ltd v Tony McFadden Utilities Ltd*,[7] and found in favour of Lonsdale.

Fraser J decided that a company in liquidation could not refer a dispute to adjudication when that dispute included (in whole or in part) determination of any claim for further sums said to be due to the referring party from the responding party. He reasoned that, at the date of liquidation, the claims and cross-claims ceased to be capable of separate enforcement. The only claim that remained in law following the liquidation was to take the account required under the Insolvency Rules. Such a claim was not a dispute arising under a construction contract for the purpose of the 1996 Act and the adjudicator therefore did not have jurisdiction to hear the claim.

The Court of Appeal

Bresco appealed the decision in a conjoined appeal with *Cannon Corporate Limited v Primus Build Limited*. Coulson LJ gave unanimous judgment on behalf of the Court of Appeal.

First, on jurisdiction, Coulson LJ considered that the adjudicator did have jurisdiction to decide a claim advanced by a company in liquidation where insolvency set off applied. In *Stein v Blake*, Lord Hoffman was not suggesting that the underlying claims ceased to exist for all purposes on liquidation: in fact, they were deemed to continue to exist so that they could play their part in the calculation of the net balance. Crucially, Lonsdale had conceded that Bresco would have been entitled to bring its claim by litigation or arbitration (just not adjudication). Coulson LJ decided that, as a matter of principle, there is no reason why a reference to adjudication should be treated differently to a reference to arbitration. The fact that an adjudication decision may not be final and binding cannot somehow extinguish the underlying claim which would otherwise exist for the purpose of an arbitration.

However, Coulson LJ went on to refer to the '*basic incompatibility*' between adjudication under the 1996 Act and the insolvency regime under the Insolvency Rules. The objective behind the introduction of a mandatory right to adjudicate, as well as other provisions in the 1996 Act, was to improve project cash flow to fund ongoing works. This aim is achieved by the imposition of rigorous time limits for the conduct of an adjudication (the adjudicator's decision must be made within 28 days of service of the referral notice) and the readiness of the courts to grant speedy summary judgment by way of enforcement. Under the 'pay now, argue later' principle, the losing party must comply with the adjudicator's decision in order to ensure project cash flow. However, that decision is only binding unless and until it is finally determined by litigation, arbitration or agreement between the parties.[8] This process is, according to Coulson LJ, '*rough and ready*' and, citing Dyson J, he considered it '*likely to result in injustice*'.[9] In contrast, the insolvency regime envisaged the taking of a detailed account as between the company and the creditor, and the careful calculation of a net balance one way or the other.

Citing the well-known decision in *Bouygues (UK) Limited v Dahl-Jensen (UK) Limited*,[10] Coulson LJ reasoned that, were an adjudicator to decide in favour of a company in liquidation, the courts would ordinarily refuse to grant enforcement of that decision. With no prospect of enforcement, the adjudication would represent '*an exercise in futility*', resulting in wasted costs for both parties and a burden on TCC resources.[11] The adjudication can and should be restrained by the courts, and Coulson LJ therefore upheld the injunction.

The Supreme Court

Bresco appealed the Court of Appeal's decision and Lonsdale cross-appealed on the decision of jurisdiction. The Supreme Court, led by Lord Briggs, unanimously allowed the appeal and dismissed Lonsdale's cross-appeal.

Jurisdiction

Lonsdale advanced a number of subordinate arguments in the Supreme Court in support of its main submission that insolvency set off automatically replaced the claims and cross-claims with a single claim for the balance, such that a dispute did not arise that was caught by section 108 of the 1996 Act.

First, it argued that a narrow construction of section 108 was required either because (i) a liberal construction was inappropriate due to the fact that adjudication was imposed upon the parties by the 1996 Act or (ii) as a means of resolving the incompatibility between the 1996 Act and the Insolvency Rules. Lord Briggs, in addressing these submissions, referred to the contrasting authority as to whether the liberal construction

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6 [1996] AC 243
7 [2009] EWHC 3222 (TCC)
8 1996 Act, section 108(3).
9 At [37]; *Macob Civil Engineering Ltd v Morrison Construction Ltd* [1999] BLR 93.
10 [2000] EWCA Civ 507.
11 At [46].

afforded to jurisdiction clauses in arbitration agreements following *Fiona Trust and Holding Corpn v Privalov*[12] should be extended to the construction of section 108 of the 1996 Act.[13] Lord Briggs opined that there was little to be gained from analysing the analogies between arbitration and adjudication for the purpose of applying or not applying the learning in *Fiona Trust*. Instead, he decided that the statutory compulsion behind the conferral of the contractual right to adjudicate in the 1996 Act did not point towards a narrow construction of section 108, and, if anything, pointed towards a more liberal construction.

Secondly, Lonsdale argued that, if they were wrong and the cross-claims were not replaced by a single claim as a result of insolvency set off, there would be multiple claims or disputes between the parties which were not capable of being separately enforced (cf. Fraser J's decision at first instance). Lonsdale reasoned that these claims could not in any event be resolved by adjudication because of the existence of the 'single dispute' rule; which provides that an adjudicator only has jurisdiction to deal with one dispute at any one time.[14] Either there was a single dispute about the net balance, in which case it did not arise under the construction contract, or there were multiple disputes which were not capable of separate enforcement (neither of which would be within the jurisdiction of the adjudicator).

In addressing this argument, Lord Briggs considered that the 'single dispute' rule would only assist Lonsdale's jurisdiction argument if the law of insolvency set off compelled the liquidator to bring all disputes about the claims and cross-claims for resolution in a single proceeding. Lord Briggs stated that the law and practice of insolvency set off does no such thing.[15] The liquidator may, if it appears economical and proportionate to do so, untangle a complex web of disputed issues arising from mutual dealings between the company and a third party by multiple methods – picking some as suitable for adjudication, others for arbitration and others for disposal by an application to the court.

Lord Briggs then went on to find against Lonsdale's main submission, considering that it represented an over-literal reading of Lord Hoffmann's speech in *Stein v Blake*. First, as a matter of common sense, the submission is too much: Lord Briggs gave the example of an insolvent company being denied adjudication for a disputed claim for GBP 300 000 by the existence of an undisputed cross-claim for just GBP 25. Secondly, Lord Briggs reasoned that, whilst claims do lose their separate identity on insolvency for the purpose of assignment (as decided in *Stein v Blake*), there are important examples where they do not. For example, Lord Hoffman himself acknowledged in *Stein v Blake* that cross-claims must obviously be considered separately for the purpose of ascertaining the net balance itself. Further, when a liquidator causes a company in liquidation to pursue a contractual claim by litigation or arbitration, it remains one based on the underlying contract, even if an undisputed set-off is acknowledged. For the reasons given by Coulson LJ in the Court of Appeal, Lord Briggs agreed that there was no reason to treat adjudication and arbitration separately in this regard.

Lord Briggs therefore found that the dispute did arise under the construction contract and the adjudicator did have jurisdiction under section 108 of the 1996 Act.

Futility

Whilst Coulson LJ's judgment was premised on his analysis of a basic incompatibility between the 1996 Act and the Insolvency Rules, Lord Briggs started from a very different standpoint: that an insolvent company has a statutory and contractual right to pursue adjudication as a means of resolving disputes under a construction contract. He considered that it would be entirely inappropriate for the court to interfere with such rights, save very exceptionally.[16]

Lord Briggs accepted that summary enforcement of an adjudicator's decision will frequently be unavailable in the context of insolvency set off (again citing *Bouygues v Dahl-Jensen*), but considered that this was no answer to the utility of construction adjudication in the circumstances. Rather, he considered that adjudication was a valuable tool for a company in insolvency. He cited academic writings which suggest that only around 2% of adjudication decisions have since been challenged in the courts.[17] Lord Briggs therefore considered it wrong to suggest that the only purpose of construction adjudication is to obtain summary enforcement of a right to interim payment. Adjudication has become, and was always intended to be, a mainstream method of alternative dispute resolution leading to a speedy, cost effective and final resolution of most construction disputes. There is therefore no incompatibility between the two regimes. Furthermore, Lord Briggs considered

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12 [2007] UKHL 40.

13 *Hillcrest Homes Ltd v Beresford and Curbishley Ltd* [2014] EWHC 280 (TCC) and *J Murphy & Sons Ltd v W Maher & Sons Ltd* [2016] EWHC 1148 (TCC).

14 *See Witney Town Council v Beam Construction (Cheltenham) Ltd* [2011] EWHC 2332 (TCC), at [38]; *Deluxe Art & Theme Ltd v Beck Interiors Ltd* [2016] EWHC 238 (TCC).

15 At [46].

16 At [59].

17 Joey Gardner, 'Latham's report: Did it change us?', *Building*, 27 June 2014

that summary enforcement would not be inappropriate in every case. For example, where the value of a cross-claim had already been ascertained and was undisputed, or where the cross-claim was found to have no substance.

As regards wasted costs and court time, Lord Briggs went on to consider that these factors in fact militated against, rather than for, admitting applications for injunctions to restrain adjudications before they run their course. The statutory 28-day time limit and document-based investigatory nature of construction adjudication means that, if left to proceed, it would probably be completed before any opposed injunction application could be determined by the court, and likely at a fraction of the cost.

In conclusion, Lord Briggs held that it would not be appropriate to injunct the adjudication from continuing. The proper time to consider the issues would be at the enforcement stage, if there is one.

Comment

The decision of the Supreme Court should be welcomed by insolvency practitioners. Construction disputes are often factually and legally complex and are notoriously expensive to resolve. Where the insolvent company believes that it is in a net positive position regarding a third-party creditor, but such position is disputed, adjudication represents a quick (and therefore inexpensive) method for complex disputes to be resolved by industry experts without the need to resort to costly and time-consuming litigation or arbitration. Whilst the decision may not be final and binding in all cases, it represents an expert's independent view of the parties' respective cases and is in any event likely to be a helpful starting point for the parties from which to negotiate a settlement of the disputes.

Equally, the decision should not necessarily be unwelcome to creditors of insolvent companies. Whilst the issue of jurisdiction does appear to have been finally decided, creditors that are unsuccessful in adjudications will still in many cases be able to resist enforcement of those decisions, if they believe them to be incorrect. The courts have, in general, taken a strict approach to enforcement of adjudicator's decisions by summary judgment. However, in circumstances where there is a real risk that summary enforcement of an adjudication decision will deprive the creditor of the right to use its cross-claim as security for a claim, the court will usually refuse to grant summary enforcement. In fact, the Supreme Court expressly recognised that the courts are well-placed to deal with such difficulties at the summary judgment stage, simply by refusing it in an appropriate case as a matter of discretion, or by granting enforcement but with a stay of execution (as in *Wimbledon Construction Co 2000 Ltd v Vago*[18]).

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18 [2005] EWHC 1086 (TCC).