

## Construction Law Update

### Adjudication and Insolvency

In the case of *Michael J Lonsdale (Electrical) Limited v Bresco Electrical Services Limited (in liquidation)*, the Technology and Construction Court (“TCC”) provided an unequivocal statement that a company in liquidation could not refer a dispute to adjudication. However, in a joint appeal alongside *Cannon Corporate Limited v Primus Build Limited*, the Court of Appeal has reviewed the relationship between insolvency and adjudication and revised the law on this issue.

#### **Bresco Electrical Services Limited (in liquidation) v Michael J Lonsdale (Electrical) Limited** **Background**

In August 2014, Lonsdale engaged Bresco to carry out electrical installation works. Bresco became insolvent and, in March 2015, entered into voluntary liquidation. In June 2018, Bresco served a notice of adjudication on Lonsdale, claiming that Lonsdale had wrongfully repudiated the contract and that certain sums were due to Bresco from Lonsdale.

Lonsdale commenced Part 8 proceedings in the TCC seeking an injunction preventing the adjudication from continuing. The TCC held a company in liquidation could not refer a dispute to adjudication seeking further sums from the responding party. Accordingly, the adjudicator did not have jurisdiction and the injunction was granted.

#### **Did the Adjudicator have jurisdiction?**

The TCC concluded that, when Bresco entered liquidation, the claims and cross-claims between itself and Lonsdale ceased to be capable of separate enforcement and, under the Insolvency Rules 2016, were replaced by a single claim for the net balance of their mutual dealings which could not be referred to adjudication.

The Court of Appeal disagreed. Lonsdale accepted that the underlying claim under the contract could be referred to arbitration or litigation and therefore it continued to exist. Accordingly, the claim could still be

referred to adjudication and the adjudicator would technically have jurisdiction to consider it.

#### **The utility of the adjudication**

However, the Court of Appeal held there is a “*basic incompatibility*” between the adjudication process and the insolvency regime meaning it is very unlikely that an adjudicator’s decision in favour an insolvent company will be enforced. The Court of Appeal concluded that:

*“a reference to adjudication by a contractor in insolvent liquidation, in circumstances where there is a cross-claim, would be incapable of enforcement and therefore an “exercise in futility”.”*

The Court of Appeal considered it would be wrong in principle for a responding party to have to incur costs defending an adjudication brought by a company in insolvent liquidation when it would be able to resist enforcement of the decision but would have to spend further sums to achieve that result.

The Court of Appeal concluded that the solution was to grant an injunction, not because the adjudicator did not have jurisdiction, but because the adjudication would not provide a meaningful result.

#### **Cannon Corporate Limited v Primus Build Limited** **Background**

Cannon engaged Primus to design and build a new hotel but subsequently terminated the contract. Primus entered into a Company Voluntary Arrangement (“CVA”) on the basis that, although it was currently insolvent, it would be able to pay its creditors in full following the recovery of sums from third parties (including Cannon) through litigation and adjudication. Primus referred to adjudication its claim for damages for repudiatory breach of contract by Cannon. The adjudicator decided that over £2.1m was due to Primus. The TCC enforced the adjudicator’s decision and refused to grant Cannon a stay of execution.

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### Should the adjudicator's decision have been enforced?

Following the same reasoning it had applied in respect of the *Bresco* appeal, the Court of Appeal held that Primus' claim against Cannon did not cease to exist when Primus entered into the CVA. Accordingly, the adjudicator had jurisdiction to decide the dispute.

However, unlike in *Bresco*, the Court of Appeal held that the adjudicator's decision against Cannon should be enforced, despite Primus' financial position. Whilst a claim by a company in liquidation is part of an endeavour to secure a dividend for creditors this is not true of a claim by a company in a CVA. The Court of Appeal concluded that a CVA:

*"is designed to try and allow the company to trade its way out of trouble. In those circumstances, the quick and cost-neutral mechanism of adjudication may be an extremely useful tool to permit the CVA to work. In those circumstances, courts should be wary of reaching any conclusions which prevent the company from endeavouring to use adjudication to trade out of difficulties."*

### Should a stay of execution have been granted?

The Court of Appeal held that the fact that a claimant seeking to enforce an adjudicator's decision is in a CVA is a relevant factor for a court to consider when deciding whether or not to grant a stay but it is not conclusive. In reaching its decision the Court of Appeal also considered:

- i. the circumstances of the CVA;
- ii. Primus' current trading position; and
- iii. whether or not Primus' financial position was due, either wholly, or in substantial part, to Cannon's failure to pay those sums which were awarded by the adjudicator.

It was held in the TCC that Primus' financial difficulties were largely caused by Cannon's wrongful termination and therefore the Court of Appeal found that the TCC had been entitled to refuse to grant a stay.

### Analysis

Following this decision, it is clear that an adjudicator will have jurisdiction in respect of a claim referred by an insolvent party. However, the question is now whether that decision will be enforced. In that respect, there are important differences between a claim by a company in liquidation and a claim by a company in a CVA.

In respect of a claim referred by a party in liquidation, it is very unlikely that an adjudicator's decision will be enforced under any circumstances. In light of the significant costs a responding party would have to incur in defending a claim referred to adjudication by an insolvent company, this decision makes clear that the correct course is for the responding party to seek an injunction. However, such unnecessary costs may be avoided altogether if liquidators refrain from referring disputes to adjudication in the wake of this decision.

The position is less clear in relation to a company in a CVA. Decisions in respect of such claims will turn on their particular facts and ultimately be subject to the discretion of the courts in considering whether a decision should be enforced or if a stay of execution is appropriate.

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